S. Hrg. 101-853

HOME HEATING FUELS CRISIS

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

JANUARY 16, 1990

Printed for the use of the Committee on Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1990

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S401-52

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HOME HEATING FUELS CRISIS

TUESDAY, JANUARY 16, 1990

U.S. Senate,
Committee on Governmental Affairs,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in room SD-342, Dirksen Senate Office Building, the Hon. Joseph Lieberman, presiding.

Present: Senators Glenn, Lieberman, Levin, Cohen, and Rudman.

OPENING STATEMENT OF SENATOR LIEBERMAN

Senator **Lieberman**. Will those who are not seated try to find seats and we will begin the hearing.

The Chairman of the Committee, Senator John Glenn, may be with us in a while, but he asked me to begin.

I want to begin by thanking Senator Glenn for his characteristic generosity and inclusiveness in giving me the opportunity to hold this hearing today. I thank my colleagues, Senator Cohen and Senator Levin for being with me. Others may be in as the morning progresses.

This is a hearing that I know is important to a lot of people throughout this country. About 12 million households in America heat their homes with heating oil. Millions of others use propane. When unusually cold weather hit last month, many of those families found themselves scrambling to get fuel to keep warm, and all of us were forced to pay top dollar to get it.

In Connecticut, the average price rose dramatically. I have two bills given to me by a consumer in New Haven, my home town; December 12, paid 88 cents a gallon, January 5, paid $1.47 a gallon. As a result of those increases, Connecticut residents alone will pay about $70 million in additional heating costs this winter, and the State will need an additional $4 million in Federal energy assistance funds to help those who cannot afford to heat their homes even under normal circumstances.

The burdens suffered by the people in Connecticut are obviously shared by those in every other State that relies on heating oil or propane in the winter. To make matters worse, consumers throughout the country probably will pay higher prices for food and other products because of higher diesel and aviation fuel prices.

Now that the bitter cold has subsided, at least temporarily, the average person has a lot of questions about what happened last month, and so do I. Why were stocks of heating oil so low coming into this winter? Inventories of heating oil have steadily declined over the course of this decade.[1] As of last October, inventories were 9 million barrels below the previous year's levels, and over 30 million barrels below the 1983 levels.

By the end of December it is estimated that our country had only about a 6-day supply of heating oil available.[2] Why? What would have happened if the cold had not abated?

Very interestingly, while inventories have declined, refinery production of distillate, which is essentially what we know as home heating oil, appears to have been higher this October, November and December than in previous years. And that conclusion is based on EIA statistics from the Department of Energy.

If more heating oil was being produced but less of it was available, where was it going? Has the current market structure affected decisions about inventories? And why did prices rise so fast?

Now, the typical consumer understands that the price of heating oil or propane will go up when the demand for oil or propane increases. But he or she deserves to know why the price rose so much and so rapidly. Why aren't retail prices falling quickly now? It did not take long for the prices to skyrocket. Now that the weather is warmer and supplies appear to have improved, wholesale prices have plummeted since the beginning of January. Why is it taking so long for retail prices to decline? Who profited from these high prices?

While both wholesale and retail prices were spiraling upwards in December, refiners' crude oil acquisition costs were relatively stable. Citizen Action, a group here in Washington, using Department of Energy statistics, estimates that refiners' profit margins per gallon of heating oil increased about 270 percent in Connecticut and Rhode Island between October and January.[3] People have a right to know if anyone benefited from this energy crisis, and by how much.

Did our Government do all that it could to anticipate and deal with this crisis? Is the Energy Department collecting data on supplies, prices and margins that is specific and timely enough to help foresee problems and to deal with them? Should the Government recommend or require minimum inventory levels?

Are there adequate plans in place to deal with an energy emergency?

We are told, for instance, that at the height of the crisis in December, foreign flag vessels carrying upwards of a million barrels of heating fuels were available. Our Government declined six of the seven requested Jones Act waivers that would have allowed them to deliver their cargo here, apparently upon the recommendation of the Maritime Administration. Why?

Many Members of Congress and State officials have called upon the Attorney General to conduct an investigation. What steps has he taken?

And finally, are we taking care of those most in need? 18.6 million households require some form of energy assistance to afford to heat their homes, but less than a third of them are receiving those benefits. Many people exhausted the funds available to them in the month of December alone.

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[1] See p. 421.

[2] See p. 419.

[3] See p. 417.

As a witness who administers energy assistance funding in New Hampshire will testify later this morning, there are people hospitalized right now with hypothermia because they couldn't afford to heat their homes. And others have apparently died for the same reason. Additional home energy assistance funding is desperately needed. Yet we hear that OMB has recommended a 25 percent cut in that program.

I think all the witness this morning should and will agree that we need not a cut but a supplemental appropriation to bolster those home energy assistance programs.

What can we do to mitigate the next energy crisis? Heating fuels are not just any commodity, they are an absolute necessity. I think we need to explore the ways to minimize shortages and drastic price increases like the ones we recently experienced.

Should a necessity like heating oil be traded on the futures market? Should it be subject to some form of governmental regulation? For example, should we set at the State or Federal level a minimum required inventory for the heating season? Should we establish regional reserves of home heating fuels? Should we establish clearer guidelines or procedures for granting Jones Act waivers in energy emergencies so needed fuel can be delivered? Can states and consumer groups help themselves by investing their energy funds in the markets at the beginning of winter, as one of our witnesses will suggest today?

Those are the questions that we are going to explore this morning. We have several panels of important witnesses representing the Government, the oil industry, market and industry analysts, State attorneys general and consumer advocates.

I should point out that of the eight oil companies we requested to appear today, Texaco is the only one that agreed to come, and I appreciate their presence and resent the absence of the others. I am confident that all of the witnesses will provide useful insights and lead us to intelligent answers.

In the course of our discussion about markets and inventories, highly complicated subjects, I hope we will not lose sight of the fact that behind the economic analyses are the flesh and blood of real people who are paying hard earned money just to keep their families warm. Supplies may have equaled demand in the classic economic sense, but somewhere in between a lot of people got squeezed awfully hard. I hope we provide some answers today, and some protection for those people, because they are the reason that we are here.

[Senator Lieberman's prepared statement follows:]

PREPARED STATEMENT OF SENATOR LIEBERMAN

I want to thank Senator Glenn, the Chairman of this Committee, for giving me the opportunity to hold this hearing today—a hearing that is important to a lot of people. About 12 million households in America heat their homes with heating oil; millions more use propane. When unusually cold weather hit last month, many of those families found themselves scrambling to get fuel to keep warm, and they were forced to pay top dollar to get to.

In Connecticut, the average price of heating oil shot up from 95 cents a gallon to $1.42 during the month of December, and that increase mirrored the skyrocketing prices throughout New England. As a result, Connecticut residents alone will pay about $70 million in additional heating costs, and the State will need an additional $4 million in federal energy assistance funds to assist those who cannot afford to heat their homes even under normal circumstances. The burdens suffered by the people in Connecticut are shared by those in every other State that relies heavily on heating oil or propane in the winter. To make matters worse, consumers throughout the country may well pay higher prices for food and other products because of higher diesel and aviation fuel prices.

Now that the bitter cold has subsided—at least temporarily—the average person has a lot of questions about what happened last month, and so do I.

Why were stocks of heating oil so low coming into the winter? Inventories of heating oil have steadly declined over the course of this decade. As of last October, inventories were 9 million barrels below the previous year's levels and over 30 million barrels below 1983 levels. By the end of December, it is estimated that the country had only about a 6-day supply of heating oil available. Why? What would have happened if the cold had not abated? Notably, while inventories have declined, refinery production of distillate was *higher* this October, November and December than in previous years, according to EIA. If more heating oil was being produced, where was it going? Has the current market structure affected decisions about inventories?

Why did prices rise so fast? The typical consumer understands that the price of heating oil or propane will go up when the demand for it increases. But he or she deserves to know why the price they paid rose so much and so rapidly.

Why aren't retail prices falling quickly now? It didn't take long for prices to skyrocket. Now that the weather is warmer and supplies have improved, wholesale prices have plummeted since the beginning of January. Why is it taking so long for retail prices to decline?

Who profited from these high prices? While both wholesale and retail prices were spiralling upwards in December, refiner's crude oil acquisition costs were relatively stable. Citizen Action estimates that refiners' profit margin per gallon of heating oil increased about 270% in Connecticut and Rhode Island between October and January. The people has a right to know who benefited from a national energy crisis and how much.

Did our government do all that it could to anticipate and deal with this crisis? Is the Energy Department collecting data on supplies, prices and margins that is specific and timely enough to help foresee problems and deal with them? Should the government recommend or require minimum inventory levels? Are there adequate plans in place to deal with an energy emergency? We are told that, at the height of the crisis in December, foreign flag vessels carrying upwards of 1 million barrels of heating fuels were available, but our government declined 6 of the 7 requested Jones Act waivers that would have allowed them to deliver their cargo here, apparently upon the recommendation of the Maritime Administration. Why? Finally, many Members of Congress and State officials have called upon the Attorney General to conduct an investigation into the supply and pricing of heating fuels. What steps has he taken?

Are we taking care of those most in need? 18.6 million households require some form of energy assistance to afford to heat their homes, but less than a third of them are receiving benefits. Many people exhausted most of the federal funds available to them in the month of December alone. As a witness who administers energy funding in New Hampshire will testify later today, there are people hospitalized right now with hypothermia because they couldn't afford to heat their homes. Others have died for the same reason. Additional LIHEAP funding is desparately needed. Yet the Administration is apparently considering a 25% cut in this program. What we need is a supplemental appropriation now to bolster the LIHEAP program.

Finally, what can we do to mitigate the next energy crisis? Heating fuels are not just any commodity—they are an absolute necessity, and we need to explore ways to minimize shortages and drastic price increases like the ones we recently experienced. Should a necessity like heating oil be traded at all on a futures market? Should it be subject to some form of government regulation? For example, should we set, at the Federal or State level, a minimum required inventory for the heating season, or establish regional services of home heating fuels? Should we establish clearer guidelines or procedures for granting Jones Act waivers in energy emergencies, so needed fuel can be delivered? Can States and consumer groups help themselves by investing their energy funds in the futures market at the beginning of winter, as one of our witnesses today will suggest?

These are the questions that we will explore today. We have several panels of important witnesses, representing the government, the oil industry, market and industry analysts, State attorneys general, and consumer advocates. I should point out that Texaco is the only oil company that agreed to testify today, and I appreciate their presence. I am confident that all of the witnesses will provide useful insights and lead us to intelligent answers.

In the course of our discussion about markets and inventories, we should not lose sight of the fact that, behind the economic analyses are the flesh and blood of real people, who are paying hard-earned money just to keep their families warm. Supplies may have equalled demand, but somewhere in between, a lot of people got squeezed awfully hard. I hope we provide some answers and some protection for those people. They are the reason we are here today.

Senator LIEBERMAN. Senator Cohen.

OPENING STATEMENT OF SENATOR COHEN

Senator COHEN. Thank you, Mr. Chairman.

Perhaps just to bring the focus toward the State of Maine for the moment. Prices in my own State doubled—nearly doubled—in less than four weeks, going up to as high as $1.50 a gallon. And 65 percent of the Maine residents depend upon heating oil to heat their homes. Nearly half of Maine's fuel assistance recipients earn less than $6,000 a year, and fuel assistance has been cut by approximately 20 percent this year over last year.

Now, we have had some reports that a number of families had to sell furniture so they could heat their homes, which is the equivalent of burning their furniture to stay warm. So for many people it really was a question of their money or their lives.

The industry has indicated this is unfortunate but perfectly understandable. It is simply a case of the free market system at work. Demand was up, supply was down, and therefore the price necessarily had to go up. And they point to the unusually early and enduring cold snap, which is true. The loss of a refinery in Louisiana, slow traffic on the Rhine river in Germany, lower reserves of heating fuel by oil companies who relied upon the National Weather Service, and a decision, as the Chairman pointed out, by the Maritime Administration to stop foreign flag carriers from bringing fuel into the United States.

And all of this may be true, but there are questions that remain. Profit is integral to our free market economy, but price fixing is not. And so we have an obligation to find out whether the market was free or the market was fixed.

It is also suggested that with 19 companies who control the supply of roughly 90 percent of all the fuel, there is little room for collusion. Now, this may in fact be the case, but our constituents have a right to know how it came to be that fuel stocks were down 8 percent nationally, or 25 percent in the New England region, and why local dealers, wholesale and retail, seemed unable to find any flexibility in the pricing structure. Are we left with the proposition that a rising tide of demand carries all oil companies to the same level of pricing?

Also suggested is the fact that the way to cut oil prices is to cut demand, and that would entail greater conservation efforts and shifting to alternative fuels. One of our first witnesses, Senator Chafee of Rhode Island, has been certainly in the forefront of the conservation effort. And I recall that as early as 1973, in fact the first piece of legislation I ever introduced, was a tax code change to encourage the conservation of energy.

But the fact is, there has been a steady retreat during the past decade from assisting in that conservation effort, in addition to cutting back on fuel assistance to the poor. And as the Chairman has indicated, we are going to see even recommendations for further cuts in such programs.

Secondly, there is a difference in this particular situation in the free market economy. There aren't many options available to oil for many people. Not everyone can either cut or buy a cord of wood. Many people live in apartments, or don't have the ability to go out and buy wood-burning furnaces overnight.

And it is not a case of free market forces at work here. If people cannot afford to go out to the Foot Locker and buy a pair of Air Jordans, they can find some cheaper substitutes at the K-Mart. In the case of heating fuel, consumers are put in the position of being told, there is no K-Mart, you can either buy Air Jordans or you can go barefoot. When it is 25 to 30 below zero, as it was in the State of Maine, that is not either a free or a fair market at work.

The chairman has raised a number of questions. I will not take time to repeat them, but I believe this hearing is important to find the answers to this question, so I look forward to the witnesses today.

Senator LIEBERMAN. Thank you, Senator Cohen.

Senator Levin.

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. Thank you, Mr. Chairman.

Mr. Chairman, the price of heating oil and propane gas in Michigan in the month of December increased from 35 to 40 percent. This dramatic price increase, coupled with a dramatic increase in the amount of these products used because of the severe cold spell, resulted in some Michigan residents seeing heating bills that had almost doubled over last year's bills.

As we all know here, we are not talking about a commodity that it is optional for a family, as Senator Cohen just mentioned. It is not like a price increase in the type of food or jeans or even a car. You can switch from tuna fish to chicken if there is a sudden increase in the price of tuna. But heat is a basic necessity. In the winter in Michigan you simply cannot live without it.

That is why a woman from Ishpeming, Michigan, was in tears when she called her State representative to complain about her propane gas bill that had gone up to $441. In the December 31st edition of the Mining Journal, which carried this story, State Representative Dominick Jacobetti was quoted as saying that she was crying on the telephone, saying that she did not make that much in 2 weeks, there was no way that she could pay that.

Mr Chairman, last week my office talked to a major retail distributor of propane in Michigan about the horrendous price increases. After quoting the then current price of 80 cents per gallon for propane, which was the highest for the year, he said, "Frankly, I don't know what many families are going to do."

Lyle and Betty Hudson of Cedarville, Michigan, sent my office four of their recent heating bills to show the outrageous increase in the cost of propane. Seeing the actual bill gives you a real feeling for what it is like to be on the receiving end of this price increase. The Hudsons were charged 75 cents a gallon for their propane on September 1 of last year. They were charged 95 cents a gallon just 1 week later on September 8, an increase of almost 40 percent in one week. On December 1st they were charged 97 cents a gallon, and then on January 2nd, just one month later, they were charged $1.32 a gallon.

That is a 77 percent increase over September 1st. Let me tell you, they are mad. All of our people who use heating oil and propane are mad, and we ought to be mad along with them. They understand that there is going to be some increase in price because of severe weather, but they cannot understand a 77 percent increase in the price in 4 months, and neither can I.

We are told by the Department of Energy that the sudden dramatic price increase is really nobody's fault. They cite a combination of events—an unexpected cold wave, shutdowns at 13 refineries, and transportation problems. However, the price of natural gas did not experience the same dramatic increase.

I would like to find out today why there is that difference. And the reserves of heating oil and propane at the beginning of the winter season were significantly below the 1988 levels. We should find out the reason for that. Moreover, concern has been expressed about the futures market and what effect that has had on home heating oil and propane gas prices to make them more volatile. We should explore that question as well today.

We have been told that short supplies suddenly became plentiful immediately after a major price increase was announced by all suppliers, and I hope we will find out from witnesses today how that could happen so quickly.

Mr. Chairman, I commend you for you initiative here today. We must get to the bottom of this. We must learn to our satisfaction just what caused the enormous and sudden increases in price. Then we must do what we can to prevent it in the future. That may be to require a specified amount of on-hand supplies or reserves. I suspect it will also require better tracking and monitoring of supplies and prices by the Department of Energy. Whatever it takes, we must do it to avoid a recurrence of this disaster of this winter.

Thank you, Mr. Chairman.

Senator LIEBERMAN. Thank you Senator Levin.

Senator Cohen, I believe you have a letter to enter into the record.

Senator COHEN. Mr. Chairman, I would like to ask unanimous consent that Governor McKernan's letter be entered into the record.[1]

Senator LIEBERMAN. Without objection, it is so ordered.

Our first witness today is our distinguished colleague and friend, the Senator from Rhode Island, John Chafee.

Welcome and thank you for being here.

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[1] See p. 371.

TESTIMONY OF HON. JOHN H. CHAFEE, U.S. SENATOR FROM THE STATE OF RHODE ISLAND [1]

Senator CHAFEE. Thank you very much, Mr. Chairman.

Senator Lieberman, I join with the others in thanking you for holding this hearing, and I want to express my appreciation to the other distinguished members of the Committee, Senator Cohen and Senator Levin, who are both here.

Let me also today welcome Rhode Island Attorney General James O'Neil, who is a later witness here, and I know his report will be extremely helpful.

As we all know, the national price, both wholesale and retail, of home heating oil skyrocketed during the month of December of last year. For New Englanders, the effect of this price hike has been particularly severe, as, of course, you and Senator Cohen both recognized.

Rhode Island has close to the highest percentage of oil heated homes in the country, a bit over 60 percent of our homes are heated by oil, compared to other sections of the country where it is way lower. According to the Rhode Island Office of Energy Assistance, Rhode Islanders paid an average of 97 cents a gallon for heating oil on December 4th. I am just using the month of December.

Two weeks later the price jumped 11 cents to $1.08. Within another 11 days a gallon of heating oil could not be had for less than the staggering price of $1.51. In other words, the retail price of home heating oil went up 56 percent in 25 days last month. If we went back to September and October, as your charts here show, the percentage increase would be much greater.[2] Wholesale oil prices did not fair any better. By December 29th suppliers were rushing to buy oil at $1.26 a gallon, an 88 cent increase from December 4th prices.

Now, we can recite figure after figure, but my first and foremost concern is the effect of this increase on our consumers. An average Rhode Island household burns about 800 gallons of heating oil annually. As a result of the steep prices the typical family may be looking at an extra heating cost of up to $400 this year. That is no small financial burden.

Can the average household afford the extra cost? Some can and some cannot. Energy costs are fixed, as you pointed out, each of you distinguished gentlemen. Rich or poor, one pays the same price per gallon of oil. That means fixed- or low-income families suffer more when prices to up since the increase takes a larger bite out of their income. National Consumer Law Center analysts estimate that the average Rhode Island widow or widower living on $488 a month of Social Security pays $80 a month, or 16 percent of his or her income, on energy.

Last Friday I received the following letter from an elderly couple in Cranston:

> Dear Senator Chafee, I am writing this letter to you in regard to the price we are paying for fuel oil. My wife and I are in our 70s and living on a fixed income. We received delivery of oil on December 5th for which we paid 99 cents a gallon. On

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[1] See p. 87 for Senator Chafee's prepared statement.

[2] See charts on pp. 417–421.

December 28th we received a delivery of oil for which we paid $1.59 per gallon. We do not think this is fair.

And I agree with them, I don't think it is fair either, as you gentlemen have also similarly received dozens of letters just like that one in the past several weeks. A heat or eat choice is no choice at all. In 1980 we in Congress took steps to help erase this inequity by enacting the Low Income Home Energy Assistance Program. This is a good program, and I have long supported it, as I know each of you have. But the energy assistance program cannot help all 85,000 families in Rhode Island qualify.

Across the Nation we have experienced record cold temperatures this winter so far. December 1989 broke every Rhode Island cold weather record for December since 1917. As a result, oil customers and suppliers alike rushed to buy fuel. Prices went up. I can understand that. In addition, refinery production difficulties, market speculation, lack of substantial oil inventories may share the blame.

However, in spite of these events I remain deeply concerned about the possibility of fraudulent pricing practices. I also recognize that most of the home heating oil dealers in New England are just as bewildered as the consumers are about the increase. And, of course, they are bearing the brunt of the consumers' anger.

Now, what can we hope to find from these hearings? Were these oil heating price increases brought about by illegal collusion? If they were, then I want those guilty persons punished. If they stole $400 from every Rhode Island family they surely would be punished. Likewise, if they illegally cause every Rhode Island family to pay $400 more for oil than ordinarily should be true, then likewise they ought to be punished.

We are now seeing retail prices come down to $1.29 and wholesale prices drop to 89 cents. However, I think we ought to keep in mind that the resident who bought 275 gallons of oil for $1.51 per gallon now has enough for three or four weeks. thus the recent drop in prices does not make any difference to that resident, they have already paid the peak cost.

So I hope, Mr. Chairman, that you and others on the Committee are able to receive from some enlightenment, and all of us, from the knowledgeable witnesses you have assembled here today. I congratulate you for your efforts and thank you very much for giving me this chance to appear here today.

Senator LIEBERMAN. Thank you, Senator Chafee, for that excellent statement. I have no questions.

Does either of my colleagues?

Thank you very much.

Senator CHAFEE. Thank you all very much.

Senator LIEBERMAN. We will now call our first panel, which is the panel of Government witnesses; the honorable John Easton, Helmut Merklein, James Rill, Captain Leback and Paul Hegland.

Let me say as you are approaching the seats that obviously this is a complicated subject matter. We have a large number of witnesses who are testifying today, and we are therefore going to impose a 5 minute limit on your opening statements, and on our questioning. We hope by that means we can move forward expeditiously and give everyone a chance to testify.

Now, I understand that two of the witnesses before us today, Mr. Rill from the Justice Department and Mr. Hegland from Customs, do not have opening statements but are available to answer questions, and that the other three will deliver opening statements.

Mr. **Rill**. I have only about a one minute opening statement.

Senator **Lieberman**. Well, you are entitled to that opportunity. Let's begin with Mr. Easton for his opening statement.

TESTIMONY OF JOHN J. EASTON, JR., ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS AND ENERGY EMERGENCIES, U.S. DEPARTMENT OF ENERGY, ACCOMPANIED BY HELMUT A. MERKLEIN, Ph.D., ENERGY INFORMATION ADMINISTRATION ADMINISTRATOR [1]

Mr. **Easton**. Mr. Chairman, thank you very much, I am pleased to be here.

I want to stress that we at the Department view the events of the past few weeks with great concern. I think we share the feeling that you and your colleagues have expressed. This price increase has affected not only individual American consumers, but our whole economy, and we are sensitive to the hardships that the rapid and unexpected increase in demand for heating fuels and the sharp rise in their prices have caused, particularly for small businesses and those on limited or fixed incomes.

I also want to say that the tight market conditions are beginning to ease as additional supplies flow into regional markets from domestic and off-shore sources. In fact, just this past weekend another ship arrived in New England at the Newington, New Hampshire terminal, and other ships are expected this week.

To begin with, Dr. Helmut Merklein from our Energy Information Administration will discuss the present energy supply and price situation, how it evolved, and give his judgment as to what lies ahead. Then I will resume my remarks and describe what we at the Department of Energy did to respond to the situation that we have been faced with during the last month.

Senator **Lieberman**. Okay. Dr. Merklein.

Dr. **Merklein**. Mr. Chairman, in your opening statement you said that behind the economic analyses are the flesh and blood of real people, and, of course, that is very, very true. Let's try not to lose sight of this, because my presentation will be somewhat statistical and dry.

Also before I get into the statistics, I want you to know that we have agreed to do certain studies in response to requests from various other sources, including the House Subcommittee on Energy and Power.

We will do a quick short-term analysis, essentially dealing with prices and margins, that are available either from public sources or from our own data bank, and that study will be completed and results will be released before the end of January. That is in two weeks.

Using our own data in conjunction with credible information from non-Government sources, we will also do a long-term, in-depth analysis to describe the December pricing phenomenon. Now, this analysis is sure to be scrutinized by local and Federal law enforcement agencies. This being the case, it is imperative that all data, including profit data, be included. As a result, the long-term, in-depth study will not be completed until after the first quarter of 1990 when 10-Q forms have been filed with the Securities and Exchange Commission.

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[1] See p. 89 for Mr. Easton's and Dr. Merklein's prepared statement.

In the meantime, of course, we have worked frantically to develop data for this hearing and earlier hearings and for the public at large. Here is what we have learned so far. Wholesale spot prices for No. 2 heating oil in New York Harbor rose 68 cents per gallon to $1.15 by December 27th from the 47 cent level seen in early August, and that is on the far chart on your right.

Senator LIEBERMAN. Dr. Merklein, let me just ask you, for sake of clarity, when you say "wholesale prices," who is selling to whom?

Dr. MERKLEIN. These are spot prices at New York Harbor. These are off-loading from the ship.

Senator LIEBERMAN. Okay. And this would be bought by the people who deliver oil to us at our homes?

Dr. MERKLEIN. I would think so. There may be deliverers in between. I honestly do not know.

Senator LIEBERMAN. There more likely would be people in between, yes? Okay.

Dr. MERKLEIN. Residential prices for heating oil also climbed. For the Nation at large they rose by about 30 cents per gallon from August through December, 24 cents of which occurred in December. This was—and I agree with you, Mr. Chairman—no consolation to consumers on the East Coast where prices in December rose by 45 cents, reaching about on average $1.40 per gallon, and considerably higher in some localities.

Now, residential propane prices also rose sharply in December. By January 2 residential prices in New York had climbed 33 cents per gallon in less than three weeks to $1.40. In the Midwest price increases were similar. For example, in Ohio comparable propane prices rose 30 cents per gallon in the second half of December.

Now, numerous factors combined to generate these sharp price increases, but by far the most important was demand, which in the case of distillate increased almost one million barrels per day, or 33 percent, to 4.1 million barrels per day in the U.S. in December.

This surge in demand was the largest one month increase in at least a decade, and almost all of it occurred on the East Coast. This enormous increase in heating oil fuel demand was generated by the unexpected and uniform widespread cold wave which blanketed most of the United States in December. On a heating day degree basis, December 27 was 27 percent colder than normal nationally, and it was 33 percent colder than normal on the East Coast. It was the coldest December on the East Coast in at least 60 years.

Now, supply factors to a lesser extent also contributed to the distillate price increase. U.S. primary distillate inventories at the end of October—that is, at the outset of the heating season—stood at approximately 121 million barrels, and that is 7 million barrels per day lower than last year's level, but they were at the same level that they were in 1987. And I hope we get into some discussions on the inventories later on.

On the East Coast distillate inventories at the end of October were 5 million barrels lower than last year's level of 57 million barrels, but they were only one million barrels lower than the year before.

Even though beginning-of-the season inventories of distillate have trended down over the years, end-of-season inventories—and people tend to lose sight of that—end-of-season inventories—and by that I mean end of April—have been remarkably stable over the last 7 years. They fluctuated from a high of 103 million barrels in April of 1983 to 95 million barrels in April of 1988. This compares to a minimum operating level as determined by the National Petroleum Council, in a study which I co-chaired with the Council, of 85 million barrels nationally.

Now, prior to the heating season in late September primary propane stocks were 60.5 million barrels. This was about 4 percent below stock levels at the same time last year, but it was 4 million barrels more than in 1987, and it was 3 million barrels more than the level in 1985.

In addition, as everybody knows by now, during the last two weeks of December a number of refineries were completely shut down or had reduced operations due to the cold weather or fires and explosions. Spot markets for distillate jumped 22 cents per gallon in 2 trading days alone on news of these refinery problems.

Now, in contrast to the distillate market where prices escalated but physical shortages failed to materialize, outages did occur in the propane market. By December 21 many propane suppliers were experiencing outages, especially in the Northeast, the upper Midwest, and as far south as Kansas and Tennessee.

With a return to more normal temperatures across most of the eastern half of the country, the distribution system is recovering and demand seems to be returning to more normal levels. And if I may draw your attention to the graph on the left that you have there, those little squares going up labeled "Product Supplied" are really proxies for demand. Demand has declined to about 3 million barrels in the week of January 7.

Demand, as I said seems to be returning to more normal levels. Production is expected to regain much of the volume lost during the cold snap. In addition, supplies will also result from sharp increases in imports during the month of January.

Distillate stocks have already begun to recover. During the first week of January they grew by 2 million barrels nationally, and they grew by one million barrels in PADD I. That is not much of an increase, but it is certainly better than a continued reduction in inventories.

Now, as you can see on the graph to your left, New York Harbor spot prices of distillate have returned to normal—that's 72 cents per gallon—as of last night. And residential prices are on their way down. In New England residential prices have dropped by 16 cents, compared to 7 cents in the Mid-Atlantic States, and 3 cents in the Midwest. That is the graph on the far right.

The spot price crisis for all practical purposes is over. The 72 cents on the far right on the lower curve, are about what you would expect this year with an adjustment for the increase in crude oil prices this year over last year, which is about 12 cents. But, of course, residential prices are not there yet, but they have broken, and are on their way down. By Thursday or so we might get another indication of where they are headed.

Propane is expected to follow the same pattern as distillate. In the first week of January terminal prices fell 14 to 17 cents per gallon in the middle of the country closest to the source of production. Other terminal prices are expected to follow suit, and so are residential prices as soon as higher priced inventory is cleared out of the distribution system.

I have included a more detailed assessment of these factors as an attachment to the statement and you have a copy of it. You can rest assured that a copy of both our short-term and long-term analyses will be forwarded to members of this Committee.

Thank you very much.

Senator LIEBERMAN. Thank you, Dr. Merklein.

Mr. Easton, we have run through the lights twice, so if you can try to summarize your testimony from here on in we would appreciate it.

Mr. EASTON. I certainly will, Mr. Chairman.

Let me just review very quickly what the Department did in December when we began receiving reports of spot shortages of propane and heating oil and we began to see the price increases. In order to gain a first-hand assessment, I called a meeting of both State and Federal officials, as well as those from the energy industry, in Washington on Saturday, December 23rd, to gain a first-hand picture of what was happening and to find out what the Federal Government could do to cut red tape and make sure that during the Christmas weekend no American went without vital heating fuels.

We felt that the first and foremost step the Federal Government could take would be to assure that the supply system worked. To do that we did a number of things. First, we worked with the other Federal agencies to try to obtain Jones Act waivers to facilitate some product movement by foreign flag vessels. Secondly, we worked to relax the tank truck driver hour limitations. Third, we worked with the Coast Guard to expedite critical refinery feed stocks movement through congested ports. We worked with the ICC and the railroads to move propane and heating oil.

I think the circumstances during this period of time were extraordinary. As you have heard, the weather was the coldest in this century in many parts of the country, and that produced effects that no one could have possibly seen ahead of time. So we feel that it was this sudden and rapid increase in demand that caused the temporary tight supply that existed, and then the rapid run up in prices which followed.

Let me indicate that we are very concerned and we are very sensitive to the needs of those Americans, our fellow citizens who were adversely affected by this. Because of these extraordinary circumstances, the Department of Energy is conducting a survey of all State energy offices to determine the current status of funds available through the Low Income Home Energy Assistance Program, the LIHEAP program that Senator Chafee referred to.

We will provide this information that we developed from the survey to the Department of Health and Human Services which administers the program, and we will consult with that agency on any recommendation for additional funding.

Finally, Mr. Chairman, let me point out that it is our view at the Department of Energy, based on our experience over the last two decades, that the complex web of energy producers, transporters, distributors and local suppliers provide the best and most sufficient means of supplying consumers' energy needs. I think reliance on markets to correct short-term supply aberrations is not an ideological imperative, it is simply just good public policy.

Thank you, Mr. Chairman.

Senator LIEBERMAN. Thank you, Mr. Easton. Obviously we will get back to you with questions.

Mr. Rill, representing the Department of Justice, we invited you here because of the widespread interest in the rise in heating fuel prices and the specific calls for the Department to investigate. Basically, we would like to ask you for a status report on what you are doing.

TESTIMONY OF JAMES S. RILL, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. RILL. Thank you very much, Mr. Chairman.

Since I am primarily here to answer questions, let me be very brief in my opening statement.

As you indicated, the Antitrust Division and the Department have received numerous complaints about the increase in fuel prices this winter, especially the prices of home heating oil. We are inquiring into the causes of these increases. If those increases were the result of conspiracies among sellers at any level there would be a basis for antitrust prosecution.

Accordingly, we have been reviewing the complaints and other information available to us to determine whether there is a reasonable basis to believe that antitrust violations have occurred. I have to stress that the Antitrust Division of the Department of Justice is not a regulatory agency, perhaps in the sense that the Department of Energy might be. It is not an agency that ordinarily conducts economic studies of industries.

To the extent that the heating oil price increases were due to market forces, including severe weather conditions and refinery facility and inventory shortages, the Antitrust Division would have no basis for taking any prosecutorial action. Should we conclude, however, that there is a basis for believing that an antitrust violation has occurred, that the increases were the result of any agreement or understanding among sellers with respect to price or supply, you can be assured that we will proceed vigorously to pursue and punish offenders.

Our inquiry is currently underway. We will be pleased to answer any questions you have as to how we are going about it, and any questions you may have with respect to any other aspect of our work. Thank you.

Senator LIEBERMAN. Thank you, Mr. Rill.

Captain Leback, we appreciate your presence. You are the Administrator of the Maritime Administration. As you can hear today, questions have been raised about Jones Act waivers that were requested during this emergency, and we welcome your testimony on that question.

Thank you for being here.

TESTIMONY OF CAPT. WARREN G. LEBACK, ADMINISTRATOR, MARITIME ADMINISTRATION, U.S. DEPARTMENT OF TRANSPORTATION [1]

Captain **Leback**. Thank you, Mr. Chairman and members of the Committee.

My name is Captain Warren Leback, and I am the Maritime Administrator, Maritime Administration in the Department of Transportation. I am here today to review MARAD's responsibility in the enforcement of the Jones Act and to describe recent actions of MARAD in handling the waiver requests to allow the use of foreign flag vessels to carry residential heating fuels and propane gas from Puerto Rico and the U.S. gulf to ports in the U.S. northeast coast.

The declaration of policy contained in Section 101 of the Merchant Marine Act of 1936 declares, as relevant to the domestic trades, that:

> A U.S. flag Merchant Marine is necessary for national defense and development of domestic commerce. It should be sufficient to carry our domestic water-borne commerce, to provide shipping services essential to maintain the flow of such commerce at all times, able to serve as a naval and military auxiliary in wartime and in national emergency, owned and operated by U.S. citizens under U.S. flag, composed of U.S.-built, U.S. citizen manned vessels, and supplemented by shipbuilding and repair facilities here in the United States.

The Jones Act is Section 27 of the Merchant Marine Act of 1920. At the time of its enactment it reaffirmed national policies that were already over a century old. Basically, it requires that all shipments of merchandise by water or by land and water between ports in the United States, whether direct or via a foreign port, must be made in vessels which are built in this country, documented under U.S. law, and owned and manned by U.S. citizens. Through its provisions the Jones Act ensures that we have in being a water transportation capability that is exclusively subject to our own national control rather than under the control of a foreign management, labor or suppliers.

A critical element of that capability is a fleet of petroleum product carriers which can be drawn upon for the movement of military fuel in wartime. The requirement for domestic construction of the vessel also works to help sustain shipbuilding and ship repair establishments which represents a critical national mobilization resource.

In the early months of the Korean war, legislation was enacted which provided for administrative waivers of the navigation and vessel inspection laws, which included but are not limited to the Jones Act. When it is deemed necessary for the national defense of the United States, these laws can be waived.

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[1] See p. 186 for Captain Leback's prepared statement.

The Customs Service and the Department of the Treasury is responsible for processing Jones Act waiver requests for the particular proposed shipments. The Customs Service seeks comments from MARAD and other interested agencies. Customs considers these comments and prepares a recommendation to the Assistant Secretary of the Treasury for Enforcement who makes the approval or denial of the waiver. Before it makes a recommendation, MARAD determines if suitable U.S. flag vessels are available to perform the shipments.

In considering a waiver, MARAD must review whether or not national defense interests would be compromised. Purely commercial delivery terms, whether or not economically vital a shipper or consignee, cannot govern the availability determination. The language of the waiver statute simply gives no standing to commercial considerations.

It should be noted, however, that MARAD's recommendations are not binding on the U.S. Customs Service of the Department of the Treasury. Our principal expertise and comments in any waiver case relate to the availability of U.S. flag vessels. The waiver process review is not done in a vacuum; the views of other agencies are also given full weight. It is possible that arguments of other agencies could prevail as to the required timing of a shipment, its relation to national defense, and a ruling opposed to MARAD's recommendation could be made.

Between December 22, 1989 and 3 January of this year, MARAD received letters from the U.S. Customs requesting advice on requests from 6 different companies for waivers to permit foreign flag vessels to transport fuel or propane between U.S. domestic ports. MARAD recommended disapproval of four requests for foreign flag carriage of heating oil because of the availability of U.S. flag vessels. However, MARAD interposed no objections to 2 waivers for foreign flag propane carriers after a thorough check revealed no U.S. flag propane carriers were available.

The details regarding the applicants and MARAD's actions on these requests are as follows: Arochem Corporation of Stamford, Connecticut. This company requested an immediate grant of an exemption from the American flag vessel requirement imposed under the Jones Act for the duration of the winter of 1989 for deliveries of No. 2 and No. 6 fuel oil shipments from the U.S. gulf coast to the East Coast.

In other words, Arochem requested a blanket waiver for the season. No particular vessels were subject of the request. Arochem did state that it had a January 15, 1990 delivery commitment for 230,000 barrels of No. 6 fuel oil destined for a major New York area heating oil distribution concern.

MARAD reviewed Arochem's request with a number of U.S. tanker operators, including representatives of American Trading Transportation Company, Inc., Cove Maritime Company, Mormac Marine Transport and Overseas Shipholding Group. As a result, Arochem was offered the following U.S. flag tankers.

Senator **Lieberman**. Captain, my apologies. May I interrupt you and just say that we have your written testimony, and I would appreciate if you could summarize the remainder of it in a few moments.

Captain **Leback**. Well, I think that a couple of these are important on the way they made their application, and I will summarize two of the major ones and discuss the other two, because in my opinion they are pertinent to the hearing.

Senator **Lieberman**. Why don't you summarize those two and then I have a feeling that Senator Cohen and I will get to the general topic in our questioning.

Captain **Leback**. Fine. In the result of this case there were 6 American flag tankers available to carry No. 2 and No. 6 oil from ports in the U.S. gulf and Puerto Rico to the U.S. Northeast. As far as the propane carriers were concerned, MARAD had no problems, as I said earlier in the statement, and recommended that waivers be given in this case.

A.I.C. Limited is the second firm that I want to bring to light, which is represented by the law firm of Lewis, Rice & Fingrsh of St. Louis. This firm had chartered the Belgium flag vessels Petrobulk Leopard to carry fuel oil from Texas to Europe. According to its application A.I.C. found early into the Leopard's voyage that it would be more advantageous to sell fuel oil in North America. And accordingly, the vessel was diverted to Freeport, Bahamas where the oil had been partially off-loaded when the application as made. MARAD recommended the denial of this request on the basis of demonstrated general availability of U.S. flag tankers.

The others, Coscol Marine asked for a substitution of an American flag vessel which was available using a foreign flag. This was denied, or recommended by MARAD to be denied. Sharpgas requested a waiver to carry propane. This was recommended by MARAD to be granted because there are no, as I stated earlier, available U.S. flag propane carriers.

In conclusion, MARAD supports the objectives of the Jones Act as being as valid today as they were when the law was enacted at a time when we already are experiencing a major decline in the U.S. flag tonnage and U.S. shipbuilding activity, it is all the more vital to preserve what remains of our U.S. flag fleet.

MARAD believes the Jones Act continues to be critically important to national defense and the commercial needs of this country. Mr. Chairman, may I also point out that a statement was made earlier about MARAD controlling the importation of fuel oil into the United States. MARAD has no colonel over the movement of petroleum products in and out of the United States nor does it have control over foreign flag tankers in the foreign trades.

This concludes my prepared statement and I will be pleased to respond to any questions.

Senator **Lieberman**. Thank you, Captain.

Mr. Hegland, do you want to add anything for the Customs Service?

TESTIMONY OF PAUL HEGLAND, SENIOR ATTORNEY, OFFICE OF REGULATIONS AND RULINGS, U.S. CUSTOMS SERVICE

Mr. **Hegland**. I submitted a statement [1] and I will dispense with an oral statement.

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[1] See p. 195.

Senator **Lieberman**. We appreciate that. Thank you very much.

Let me begin the questioning with the Department of Energy. Mr. Easton, Dr. Merklein, it seems to me, based on your testimony this morning, that you have reached a conclusion which I, for one, am not ready to reach. And that is, to paraphrase what you said, that the market is the best and most efficient means of supplying consumers, both residential and business consumers, with their heating oil.

And I ask you how you can say that in light of what happened in December? The statistics available through your own department suggest that the price of crude went up during December by about 6 percent, and yet the wholesale price that the refiners were charging went up 78 percent.

The general supply on the world oil markets was ample, and yet we all ended up paying almost 50 percent more at our homes and our businesses for heating oil. So it seems to me that, certainly during the month of December, the market was not the best and most efficient means for supplying the American people and American businesses with heating oil.

Mr. **Easton**. Senator, as one who is paying the same high cost of heating fuels that everyone else is, I am likewise not happy about that situation and would be the first to agree with you that in December the market did indeed work a severe inequity on many American consumers. At the same time, however, the price of that inequity has been that during the preceding years there was perhaps a much lower overall price of heating fuels and other petroleum products than we might have encountered had we not had the free market system.

And so because of that we feel the free market system is the best way to supply the needs of the American public and the country as a whole with protective features such as the LIHEAP program to deal with those aberrations that occur and the inequities that result.

Senator **Lieberman**. You know, I appreciate that, and I certainly agree with what you say about the importance of the energy assistance programs for the poorest Americans. But as so often happens, it is the small businesses, it is the people in the middle, the middle income homeowners, who are hit pretty hard by these increasing costs. And somehow most of them make it without governmental assistance.

While I agree with you that we have to help keep people at the bottom from freezing to death, we cannot just sit back and say that this was okay if all those millions of people in the middle are being treated unfairly and paying a lot more for home heating oil and propane than they would otherwise have to pay.

Let's just accept for a moment your contention that the market may work well in some of the cases most of the year. But can we just walk away from this experience in December and say we don't have to do anything except to give some more money to the poorest in our society to make sure the system is functioning fairly?

Mr. **Easton**. No, I don't think we walk away and learn no lessons from this. That is one of the reasons, for example, that we at the Energy Department have asked our colleagues to get together in the near future and look at this whole situation of Jones Act and how does it work and how can it be improved, and does it work as Captain Leback wants it to in order to protect American shipping interest and at the same time not impose an adverse effect on American consumers at other times.

So we are learning lessons from this and we are trying to apply those lessons. My point earlier was simply that it has been at least 6 years since we had the last spike in December prices, a spike that was smaller than this. During that period of time American consumers and American businesses have enjoyed a more favorable energy picture than they would have had we had the strong hand of Government regulation. So I think it is important that we recognize that although it is desirable to try to avoid policies which cause these sharp spikes, at the same time when they do occur we need to have appropriate mechanisms to deal with it.

Senator **Lieberman**. Well, okay. I agree with that. I just don't hear enough about what we can do to avoid this the next time around. The Jones Act waivers are an important question and we will come back to them. But as I understand it, if all the waivers had been granted, it might have brought in enough additional oil to meet only about a one day's additional demand during December. So clearly that was not going to be the solution to the problem.

I wonder, as you look back at what happened in December, should DOE have acted earlier? I know you brought people together on December 23rd, but to me that seems late in the problem. I presume you were aware that inventories were lower than normal.

Don't you think that there was something you could have done to protect the American consumer, something you would do the next time these conditions occur?

Mr. **Easton**. Well, as you know, the Department of Energy since 1981 has not allocated product nor controlled prices. So in that sense the Department would not have any power to start redirecting ships and product or setting prices or stopping the price rise from occurring.

What we can do, however, is stay on top of the situation, as we did in December, and make sure that there are no impediments to the operation of the free market system. At the same time we also have to consider what is the price of insurance that we want to pay for the coldest December in this century?

I am not saying that we should simply walk away from this and say, well, it was the coldest December on record and therefore we are never going to have another one. But in terms of the cost of some Government program versus the normal operation of the system, I think it is important for us to put this in the proper context. It was the coldest December in this century, and therefore what do we want to do in terms of Government programs to protect against that one December this century?

Senator **Lieberman**. Well, that is the question. My time is up on this round. But I want to say that from what I have heard so far I deem the Department of Energy answers to that question to be inadequate, if it is that all we need to do is expand or reconsider the basis for Jones Act waivers.

Well, I will be back. I want to yield now to Senator Cohen.

Senator **Cohen**. Dr. Merklein, you indicated that the supply of distillate was 7 million barrels per day lower than in 1988 but the same as that of 1987. And then you made a statement, "At the end of the season inventories have been remarkably stable of a 7 year period," which struck me as being the equivalent of saying you can drown in a pool of water that is only on an average 2 feet deep. I don't understand some of the statistics that you gave.

Could you tell me how much money, from your studies, was lost during the year, let's say 1987?

Dr. MERKLEIN. How much money was lost?

Senator COHEN. By the oil industry. Have you accumulated any such statistics?

Dr. MERKLEIN. Yes. I don't have it with me, but I can assure you that for the last 5 years in comparison with the Standard & Poor 400 operations, the group of oil companies' rates of return that we observed have consistently been substantially below on a quarter-by-quarter basis, and on an annual basis, the Standard & Poor 400 minus the oil companies.

The oil business is not really a very good business to be in in the long run right now.

Senator COHEN. So the oil business basically is down, profits have been down for the past decade?

Dr. MERKLEIN. Yes, sir, they have been down, not just producers, refiners as well, and particularly drillers and service companies. It has been an industry in recession ever since 1986, but the profits weren't overwhelming even before that.

I will be happy to submit additional information on that.[1]

Senator COHEN. So profits have been down during the past 7 years or longer in the oil industry?

Dr. MERKLEIN. Yes, sir.

Senator COHEN. And it is fair to say then that in 1988 when the oil suppliers found that they had excess inventories on hand at the end of the season a decision was made to reduce those inventories for the coming year?

Dr. MERKLEIN. Well, I have two charts in the package that you have, which is labeled "Attachment to our Statement." They are Chart No. 5 and Chart No. 6. You may have trouble finding that, but maybe I should just pass my chart on to you.

Senator COHEN. That's all right. Just answer the question.

Dr. MERKLEIN. Okay. In answering the question, in the last 8 years inventories at the end of the season have been running, as I said, consistently about 15 million barrels above what was needed to be at minimum operating levels.

Senator COHEN. That is what I am saying. The decision was made in the past year that because inventories have been running high that collectively there was a decision, or individually, to reduce the supply of that inventory.

Dr. MERKLEIN. Starting inventories did come down, and they came down particularly in the years 1980 through about 1982. That was the big drop.

Senator COHEN. I am talking about last year. You indicated that 7 million barrels per day lower this year than last year, 8 percent reduction nationwide, roughly a 25 percent reduction in availability in the Northeast region.

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[1] See p. 388.

Dr. **MERKLEIN**. Yes. Well, the year before that they were the same as they were last year.

Senator **COHEN**. I understand that. I am just asking from 1988 to 1989.

Dr. **MERKLEIN**. From 1988 to 1989 they were 7 million barrels less than the year before, correct.

Senator **COHEN**. So there was a decision, either individually or collectively, to reduce the inventories for the next year, a sound business decision?

Dr. **MERKLEIN**. Well, I would assume that oil companies—but they are here to speak for themselves—would want to reduce all kinds of costs, including the cost carrying inventories. And they had done well 2 years earlier with this level of inventory. I rather doubt that they collectively make those decisions, frankly.

Senator **COHEN**. It just sort of ended up that we have roughly an 8 percent reduction nationwide, average?

Dr. **MERKLEIN**. I might speculate that this year may be incorporated in their learning curve and that next year they would probably be not quite as low.

Senator **COHEN**. Mr. Rill, let me ask you, have you opened a full investigation into the antitrust implications of what has taken place during December of last year?

Mr. **RILL**. We are undertaking an inquiry right now.

Senator **COHEN**. You call it an inquiry. I asked you was an investigation underway?

Mr. **RILL**. Well, I think it requires some understanding of how we operate in the conduct of an investigation.

Senator **COHEN**. I was wondering about the criteria, because I noticed that the Justice Department did not hesitate to open up an investigation into—last summer three lobstermen decided to tie up their boats. They were upset about the price of lobster. Three boats tied up and we had a Justice Department investigation for an antitrust violation.

We have three colleges in the State of Maine, Bates, Colby, and Bowdoin now, under investigation for price fixing on tuition. What I want to know is, is there enough incentive for the Justice Department to open up an investigation into some of the largest companies in this country, when you are investigating three lobstermen and three colleges?

Mr. **RILL**. Well, whether or not we open up what you are determining as a full or formal investigation depends on whether or not there is a reasonable basis to believe that an antitrust violation has occurred. When we see an event taking place such as the dramatic price increase that happened in December in home heating oil, obviously, we have an interest in the causes for that price increase.

Of course, as you know, Senator, we have received a number of complaints, a number of inquiries from consumers, from you, from other Members of Congress. What we will do is undertake to, first of all, solicit any information we can from anyone who wants to provide it to us. We urge that those who are complaining give us any information that suggests that the price increase was from collusion rather than the result of market forces.

We have also been in contact with the Department of Energy. They are undertaking a full scale analysis, both a preliminary and full phrase analysis. We want to determine on the basis of what the Department of Energy is able to tell us their view as to whether or not all or any part of the price increase could be the result of other than market forces.

If those are leads that we can follow, either from the economic analysis of DOE or from any information that may come forward from informers, that will certainly give us the reasonable basis to go forward and bring this matter to the attention of a grand jury.

I have to say, Senator, that the mere fact of a price increase traditionally, historically, under the practice of the Department of Justice is not in and of itself the basis for the convening of a grand jury. We need more than that. We need either informers or we need some economic facts to justify that.

Now, I cannot talk about your lobstermen or the colleges because those are, as you indicate, pending investigations, and I cannot go beyond that.

Senator COHEN. Just two quick points. Number one, I don't think you have to have a grand jury convened to conduct an investigation.

Mr. RILL. I agree.

Senator COHEN. So that is not what I am suggesting. I am just asking what sort of resources are being marshaled to really fully investigate as opposed to relying upon voluntary supply of information? There is a big difference in the quality and the quantity of information you are going to get.

A final point, if I can, Mr. Chairman, just on the price fixing aspect. Mr. Rill, could you give me your opinion as to whether or not the Jones Act might contribute to price fixing on the part of U.S. shippers?

Mr. RILL. I have no a priori basis for suggesting that it would contribute to price fixing. The Jones Act does itself constitute a departure from what would exist in a nonregulated competitive market. It is a regulated intrusion into the marketplace made for, I assume, valid policy reasons, but nonetheless policy reasons outside of our purview.

We generally oppose regulatory intrusions in the marketplace, and we are very vigilant where those regulatory intrusions occur to be sure that the regulation isn't extended from public regulation to private collusion.

Senator COHEN. Well, Captain Leback pointed out price is not a factor, cannot be a factor in the consideration as to whether to grant a waiver, and you might very well find the situation in which companies here might decide or want to import their fuel from a foreign flag carrier because of the lower cost, and the American shipping companies sitting back knowing they are fully protected against that kind of competition, therefore hold the price up, which then contributes to the reduction in supply.

Mr. RILL. Let me say that I was delighted to hear this morning that the Department of Energy is evaluating various aspects of the Jones Act. I think it is a very worthwhile undertaking.

Senator LIEBERMAN. Thank you, Senator Cohen.

Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

First, Senator Riegle asked that his statement be made a part of the record and I would make that request at this time.[1]

Senator LIEBERMAN. Without objection, it is so ordered.

Senator LEVIN. Thank you. First, Dr. Merklein, were the reductions in the inventory about the same for all of the major oil companies?

Dr. MERKLEIN. I would not know that. We carry the statistics on distillate nationally and by PADD——

Senator LEVIN. And by what?

Dr. MERKLEIN. By Petroleum Administration for Defense Districts.

Senator LEVIN. Do you think that is a significant fact to find out in terms of whether or not there might be collusion, as to whether they acted to reduce inventories?

Dr. MERKLEIN. Well, I think it probably would be.

Senator LEVIN. Could you find that out for us?

Dr. MERKLEIN. I am not so sure that we can. And the reason for that is that as a statistical agency we do not engage in individual company investigations. That is not our purpose in life. And we have specific guidelines to protect proprietary information like that. That would have to be through a judicial investigation.

Senator LEVIN. In other words, if you asked the oil companies for that figure, they would not give it to you?

Dr. MERKLEIN. They probably would give it to us; we do have subpoena powers, but they would give it to us with the understanding and within the knowledge that this material was not available for judicial or other compliance purposes on a company-by-company basis. If we were to break that understanding, then we would have a very difficult time in the future in collecting any individual company data. And so we have guarded that right to not give out individual company data rather jealously.

Senator LEVIN. Is the 7 million barrel figure, then, not a compilation of each company's figures, or does it come from some other source?

Dr. MERKLEIN. No, it is all companies. It is the aggregate number for the Nation.

Senator LEVIN. Well then, don't we know the companies' individual reduction in order to come up with the total of 7 million?

Dr. MERKLEIN. Can I consult with Dr. Cook? He is sitting behind me and he actually collects the data. I think he could give you a better detailed answer.

Senator LEVIN. Well, while you are consulting, let me ask Mr. Rill a question.

Would you think that is a relevant question in terms of whether there was any indication of an antitrust violation?

Mr. RILL. It would certainly be a relevant question, Senator. I'm not sure it would be dispositive, but it would be certainly something we would be interested in knowing.

Senator LEVIN. So that is something you would seek to find out?

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[1] See p. 368.

Mr. **Rill**. Something that we hope would come forward from the analysis of DOE.

Senator **Levin**. And if it doesn't come forward, would you ask for it?

Mr. **Rill**. I don't know that, Senator. I would have to look at that in the context of everything else that we have in front of us at that time. As I say, it is a relevant question; whether it is a dispositive question or not, we would have to know——

Senator **Levin**. If the oil companies prices to the distributors all went up by about the same huge amount, would that fact, if it were true, be relevant to you?

Mr. **Rill**. Certainly it would be relevant. Of course, possibly there would be three inferences one could draw from that, and not all of them would be collusion.

Senator **Levin**. If they all went up different amounts, that would suggest that there was not collusion?

Mr. **Rill**. Not necessarily. I think it would depend again on the circumstances as to whether or not the price demand pulled or whether there were other factors. I don't think prices alone gives us enough to go on.

Senator **Levin**. I'm not suggesting that prices alone do. I didn't use the word. But you are saying then that if it were a fact that the prices went up about the same amount on the part of each of the oil companies, that would not in and of itself be more of an indicator of collusion than if there was a very significant price increase differential?

Mr. **Rill**. What I said, Senator, was that I would not reject the hypothesis of collusion merely because there were minor differences in the price——

Senator **Levin**. I didn't say minor.

Mr. **Rill**. Direction is the issue, and the cause of direction.

Senator **Levin**. Mr. Rill, I didn't say minor differences, I said significantly different increases.

Mr. **Rill**. Significantly different would perhaps be less conducive to a conclusion of collusion than identity, certainly.

Senator **Levin**. Dr. Merklein?

Dr. **Merklein**. That is correct. We do collect the data company-by-company.

Senator **Levin**. Are you going to be able to turn that over to the Justice Department?

Dr. **Merklein**. We have resisted such efforts. In fact, in some instances we must get additional protection on consumption data by collecting through the Census Department, which is absolutely fireproof; there is no way to get that.

I might add something else by the way. There was a one-million-barrel-per-day increase in consumption. Based on a rough calculation, we think half of that probably was the actual burning of fuel and the other half as topping; half of it is really to be blamed on the extraordinary circumstances that caused consumers to make a run for the available inventories.

Senator **Levin**. My time is up. Thank you, Mr. Chairman.

Senator **Lieberman**. Thank you, Senator Levin, and welcome to our distinguished colleague from New Hampshire, Senator Rudman.

Senator **Rudman**. Thank you, Mr. Chairman. Let me just compliment you on your initiative in calling these hearings. I think that this Committee and its major Subcommittee, the Permanent Subcommittee on Investigations, certainly has the authority and I think the obligation to move in the direction that has been suggested in these hearings, and particularly if the Executive Branch does not move in some directions which I think are reasonable and prudent.

Mr. Rill, I really want to ask you a few questions. I have not met you before. I guess that now holding the position you hold you are aware of the fact that there has been major discontent and confrontation between the Congress and the division of the Justice Department you now head prior to your stewardship, culminating in some extraordinary action brought by the Congress in terms of preventing the Justice Department's Antitrust Division from making certain arguments before the United States Supreme Court, a step that we took very reluctantly.

But I say that as a way of preface, because our experience, particularly those of us who have had extensive antitrust experience before we came here, has been something less than satisfactory from the point of view of enforcement of antitrust legislation, resale price maintenance legislation, and other legislation. The Justice Department, going back to Mr. Baxter, tends to take almost a free market approach even in the case, in my view, of obvious collusion.

That brings me to my question. I just happened to catch the end of your response to Senator Cohen, and it was kind of a curious response, and I want to see if I understand it correctly. In answer to his question you stated that you were going to look to see whether or not you received evidence to back up the complaints from not only the Department of Energy but from Members of Congress, from consumers and so forth, that would give you some cause to move forward.

Is that a correct restatement of what you said? I have watched carefully.

Mr. **Rill**. What I was trying to do was to explain the flow of an Antitrust Division investigation from beginning to end. And the initial phase of the investigation, obviously, where there are complaints, as there have been in this case, is to evaluate the complaints, urge the complainants to send any and all information that they would send in so that we would determine at least at that initial phase whether there was a basis for going forward.

Following that, where there is another Government agency with expertise in the field and conducting an inquiry, we clearly want to get the input from that Government agency. And in that context, we have been actively involved with the Department of Energy in its briefings, and personal contacts between me and Secretary Easton to see whether or not 1 of 2 things appeared to be likely. That is, the possibility of finding informers or those who were involved that can shed light on whether or not there was actually expressed collusion in the marketplace, or secondarily, to determine whether or not a sharp price increase in any instance, this one as well, can be explained by or is likely to be explained by any force other than the operation of the marketplace.

If we pass that initial phase, particularly in this instance, the secondary inquiry, it appears that there are events out there that cannot be explained about the marketplace, we reach out and talk to people—we are doing some of that now—in the industry to get an explanation of what they see might have happened.

Then at that basis—and this is historic going back I am told much further than Professor Baxter, historic prosecutorial traditions of the Department—then if there is a reasonable basis to believe that there may have been an antitrust violation, then we will bring the matter to the attention of the grand jury and use formal process.

Senator RUDMAN. Well, yes, but as a practical matter, Mr. Rill, I mean, I don't know your background but it must be a rather good one to hold the position you hold.

Your experience tells you that, you know, Senator Cohen and I who have written to you, we don't have any information other than what appears to be an unusual situation with only one or two answers. You call it market forces. You know, price gouging, that is legal. There is no law against price gouging that I see on the books.

Antitrust, that is wholly different. But we don't have the information. And I've got a bit of a time problem here. Our constituents don't know what is going on with these companies, maybe nothing is going on. The Energy Department, I don't know how vigorous their investigation is going to be in terms of documentation.

Let me just ask you this question. From my own experience, as you look at a situation in which as much money changed hands as quickly—you are talking about, I don't know whether it is hundreds of millions, or billions, but I know in New Hampshire when you go from 90 cents to $1.52 in the space of a few weeks, somebody has made a lot of money. Now, there is no law against making a lot of money.

But if it comes within any of the direct or secondary intents of the antitrust legislation and all of the cases thereof, then it seems to me that the basic information that you need is the information of the price flow of all of these companies during a period of a relatively brief period of time, 6 or 7 weeks, that you need to subpoena those kinds of documents, either DOE or the Justice Department, as the threshold to see whether or not there is evidence of collusion.

How else are you going get it? And my question is, do you intend, either through voluntary process or compulsory process, to find out what went on in the pricing structure during this six-week period? That is my question.

Mr. RILL. At this point, Senator, I can only say that we are going to pursue it through the DOE. We are inviting people to come in and give us information. Whether we go to compulsory process—yes, we are going through voluntarily process—go to a compulsory process, that will depend on our analysis at the next stage.

I can assure you that if we have any reason to believe that there is an antitrust offense out there, we are going to investigate and if appropriate, prosecute that offense. But I don't depend on you and Senator Cohen for all of my information.

Senator **Rudman**. Well, I notice that you were with a major law firm—my staff has informed me—for 30 years heading up their antitrust division, so you know better than I do that nobody is going to voluntarily give you evidence of price fixing.

Mr. **Rill**. That is not necessarily true, Senator. Informants come forward all the time in our antitrust investigations.

Senator **Rudman**. I am talking about principals.

Mr. **Rill**. Informants lead to principals, Senator. It happens all the time.

Senator **Rudman**. Well, it would help, Mr. Rill, that you be aggressive. Because if at the end of this whole situation we tell the American people there was price gouging here, here is who made the money, but there was no law against price gouging—a lot of Americans think there ought to be a law against price gouging—unfortunately once you get into that you start regulating markets, and I understand that problem.

But let me just tell you something, Mr. Rill, so you understand clearly I think where a lot of people here are coming from. I would predict that if you don't get the base data to make a determination that there was not price fixing, or if there was, you brought action, I would be willing to bet that under the broad subpoena authority of a number of committees of the Congress that we will get the information. And I don't think we ought to be doing that. I think you ought to be doing.

Mr. **Rill**. Senator, I agree with you. I will certainly aggressively pursue this, and pursue it along the lines that I have discussed.

Senator **Rudman**. Fine. That's my message. Because I believe the Executive Branch of this Government, which is always complaining about interference by the Congress in a whole variety of areas, is right sometimes, but the reason that it happens quite often is because of our ultimate discontent with what we think is action in the field. I expect you will make sure that doesn't happen in this case.

Mr. **Rill**. Senator, you can count on our doing an aggressive job with this matter.

Senator **Rudman**. I thank you very much, Mr. Rill. I appreciate it.

Mr. **Rill**. Thank you.

Senator **Lieberman**. I thank Senator Rudman. I cannot restate his point too strongly; he reflects the opinion of people on this Committee and in the Congress generally. And I appreciate your responses, because for a while as I was listening, it frankly sounded like the right hand was not communicating with the left hand. If DOE is gathering data on this problem and you need it, it seems to me that you ought to find a way to get it from them.

And the kind of anger that Senator Rudman expresses is also justified historically, though you were not a part of that history. In 1983 and 1984, when the last dramatic increase occurred in home heating oil prices, there was a Justice Department antitrust investigation, but to the best of my knowledge it relied entirely on publicly available information and on voluntary statements by the oil industry. And that is just not going to be enough in this case.

You are the right people to do it. I am a former Attorney General of my State, as is Senator Rudman, and we know the difficulty of these cases. They are almost impossible to conduct at the State level, and they should not be conducted at the Congressional level, honestly. But if it does not happen at the Department of Justice, it is going to happen here. And therefore I really urge you to go to the subpoena as soon as you can. Compel information so you can reach a judgment that all of us can be confident was based on the most thorough investigation.

What is on the line? $70 million of extra payments in the State of Connecticut alone. That means it must go, Senator Rudman, to billions, or at least over a billion nationally. That is a lot of money that somebody made and we ought to find out whether they were violating the law in doing that.

Mr. RILL. Well, I understand totally the magnitude of the issue, Mr. Chairman and Senator Rudman. We are going to do the best job we absolutely can. Thank you.

Senator LIEBERMAN. We will be watching.

Mr. RILL. Thanks.

Senator LIEBERMAN. Mr. Easton, Dr. Merklein, on the question of inventories, which is central here, you know there have been allegations that inventories were intentionally held down by the oil industry, as a way to create a crisis from which they could benefit by raising prices.

What puzzles me as I look at some of the statistics, including primarily statistics from your own department, is that there was an enormous amount of distillate, of home heating oil, being produced by the refineries, and yet the inventories, the supplies available to the American market, were for some reason down.

Mr. Lichtblau, the outside consultant who testified before the House Energy Committee, said that in the 4 weeks prior to December 22nd the refineries were producing more home heating oil and diesel than they had in 10 years.

So what happened? Where did it go? And how do you respond to the argument that the oil industry intentionally held down inventories?

Mr. EASTON. I will start, and maybe Dr. Merklein can supplement my answer if he has some data that I do not have.

To the best of our knowledge we have not seen anything yet to show intentional collusive behavior to hold down inventories. We have seen, as Dr. Merklein indicated, a trend over the last decade in lower starting inventories. However, at the end of the heating season in practically every year the finishing balance was very close to the same as the year before.

So although starting inventories may have been down over the decade, they always finished at roughly the same level, which was comfortably above the minimum operating level.

In addition, I think one explanation is that although the refineries were acting at very high capacities in December, it was in part due to this tremendous increase in demand, a demand that went up from 3 million barrels a day to 4 million barrels a day just in that month alone.

Senator LIEBERMAN. But why wasn't it there to meet that demand? If refineries began to produce at a higher level at the end of November, it should have been in the market by the first couple of weeks of December.

Mr. EASTON. That leads to the next problem we were having during December—problems of getting the supply to the market. From the investigation we have done so far, it appears that the biggest problem in December was not one of supply and production, but it was more one of transportation—the inability of pipelines to deliver the product and of some of the barges to get up parts of the Mississippi that were closed. For example, we mentioned in the end of December the Port of New York because of the spill in the Arthur Kill.

So a number of these things were also taking place in December and were causing transportation and logistics problems.

Senator LIEBERMAN. I want to ask you to go back and take a look at that if you would. Because the information we have looked at says outright that refineries were producing at a higher level in the entire last quarter of 1989, October, November and December.

My time is up. I just want to come back to one question, very briefly, for Captain Leback and yourself, on this question of the Jones Act.

Would both of you, or either of you, favor amending that law to give the President or DOE the authority to waive the Jones Act, not just in defense emergencies but in what might be called commercial emergencies as well, such as existed in December in this country?

Mr. EASTON. This is one of the topics that we hope to discuss when we get the interested agencies together. I would not say necessarily a wholesale amendment or exemption would be in order, but we certainly want to make sure that we are operating effectively to grant waivers where waivers are necessary. And I think if there are some areas to be worked out, they pertain to definitions.

For example, what does the "availability of shipping" mean? I think in the past our departments may have taken a different approach to that definition, the availability of a U.S. bottom.

Senator LIEBERMAN. Captain Leback.

Captain LEBACK. I am not sure that you need an amendment. You may only need some administrative changes in who asks for the waivers. As you note, in this case it was the wholesalers that asked for the waivers. And in several cases it was very plain that the wholesalers were asking at a very late date, or a very late hour in the day, regardless of the fact that there was shipping available out there.

It may be that in our discussions with DOE that we can do it administratively rather than do it legislatively.

Senator LIEBERMAN. That is going to be an important topic for this Committee, and I am sure for others in Congress who are concerned. I would urge you to reach a position as soon as you can and let us know about it so we can determine how to proceed. Although that was not clearly the answer to the problem, it would have, I gather, put about a million barrels of oil into the Northeast at a critical point and might have affected pricing of the product.

Senator Cohen.

Senator COHEN. I know we have got four other panels, Mr. Chairman, so I will just try and follow-up briefly with Captain Leback.

You indicated that the maritime industry, itself, was in tough shape. In fact, it is in shambles, and we have known that for decades now and done absolutely nothing about it. And the purpose of the Jones Act to try and protect that as part of our national security interest, keeping shipping companies alive, the construction business alive as such, but I don't know of many yards in this country today that produce ships commercially. Most of them are purchased by the Navy. You don't have many ships being produced in the United States today.

So we have a situation where we have got to start producing more ships, developing a maritime strategy. We have had a maritime Blue Ribbon Commission. They have all said the same thing year after year and we have done nothing about it.

What we have now is an ever decreasing number of American ships who are put in a position of having tremendous leverage during a period of crisis. And that is why I raise the issue. If you look at the question of these six requests, you said that there were plenty of U.S. ships available. I assume that they therefore were located in regions that could have delivered the supply just as rapidly as the foreign vessels, so it had to be a question of price. Someone was trying to get a cheaper price by going through a foreign competitor, I assume.

What we have got to do, it seems to me, is to build a maritime industry that would allow real competition within our own American flag vessels, and we don't have that right now because we don't have the ships. So that is something else that has to be taken into account as we look at the revision of the Jones Act.

Senator LIEBERMAN. Thank you. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman. Is it clear, Mr. Easton, that the major increase in prices were the result of increases in prices from the oil companies to the distributor and not an increase in price from the distributor to the customer?

Mr. EASTON. Dr. Merklein thinks he may have an answer to that, Senator.

Senator LEVIN. Sure, that is fine.

Dr. MERKLEIN. We have looked at the margins, and in the case of distillate most of the margin increase took place upstream of the terminals and mostly around the refineries, as opposed to downstream of the terminals around the distributors. The difference at the very peak was on the order of 40 cents versus 10 cents. Those are very preliminary numbers.

Senator LEVIN. Could we just stop there for a minute. In other words, the price increase by the distributor to the customer went up only one quarter as much as the price the distributor got from the wholesaler.

Dr. MERKLEIN. That is approximately correct. In distillate that is about correct.

Senator LEVIN. Who are the wholesalers? Those are the oil companies we have been talking about; is that correct?

Dr. MERKLEIN. Well, the oil companies and input refiners.

In propane the story is different. In propane the split is more evenly shared by the distributors and by the refiners. And that is, by the way, one of the reasons why we want to do the long term study, because we don't know whether additional costs are associated with that. We don't know what the impact is on profits, for example. So you will have a quick margin analysis and then a long term impact study.

Senator Levin. Going back to these preseason inventories which were lower this year from last year, does the DOE have an opinion as to whether or not that was an adequate preseason inventory? Do you reach any conclusions on that?

Dr. Merklein. Well, I think on inventories, at least at the national level and in PADD I as regards distillate, where we have better data collection than we do in propane, yes, it is my opinion that there was no cause for concern until about mid-December. We publish inventory levels weekly. And as a matter of fact, allegations have been made that we have not been warning people.

The fact is, we just put out the data. And then, of course, you had a sudden run on inventories. John Easton's explanation was absolutely correct. I would like to add one thing to it, and that is at the height of the price increase for distillate, December 27, the Rotterdam prices, spot prices, exceeded New York prices by about 40 cents, and there was no way that imports could flow with that reverse to the normal season price differential. It has come down now.

Senator Levin. Is your answer, then, to my question that the DOE does not make a judgment as to whether or not the preseason inventory level is adequate? You do not draw any conclusion?

Dr. Merklein. Well, you asked me, I thought, for my personal opinion.

Senator Levin. No. I'm saying does the Department reach a conclusion of any kind?

Dr. Merklein. Well, I cannot speak for the Department on this because we are an independent agency.

Senator Levin. Okay. Does the Department reach any conclusion as to the adequacy of the preseason inventory? If you see it declining from the prior year, do you say "whoops, there may be a problem," and let that opinion be known in the industry?

Mr. Easton. We have looked at the inventory levels in the past. As I mentioned earlier, each of the past several years, although there has been a downward trend in the starting position, the finishing position at the end of the year was within 5 million barrels of the year before. So it varied between 95 and 100 million barrels in almost all of the last several years.

So on the basis of ending inventories and starting inventories, we did not feel that the—and weather predictions and the fact that gasoline production had been very, very high—we did not feel that the industry was going into the season with abnormally low levels.

Senator Levin. And if you did reach the conclusion that they were too low, would you have expressed that opinion to the industry? Can you just give me a short answer on that? If you did think they were too low, would you have expressed that opinion to the industry?

Mr. Easton. It is a hypothetical which we have not encountered, and I am not sure that we would based on our past experience of recommending minimum inventory levels, which did not work out too well.

Senator Levin. Finally, the testimony which you gave this morning was slightly different from a draft of your testimony—I was curious as to why it was—relative to the impact of the futures market on these preseason stock build-ups. In your draft testimony you said that certain costs, coupled with the emergence of the futures market may have permanently altered refiner and distributor inventory behavior by acting as disincentives to preseason stock build up.

But I notice in your testimony this morning that you left out the reference to the emergence of the futures market as being one of the possible causes for the reduction in preseason stock build up.

Could you tell us why you left that fact out?

Dr. **Merklein**. Maybe I should address that. My personal view is that the futures market acts as a risk transfer agent. The idea is that inventories will be reduced as much as possible within the framework of sound operating practices. And if you can sift out an element of risk in holding inventories, you can afford to keep down inventories.

The fact of the matter is that over the last 8 or 10 years the industry in this country—and by that I don't necessarily or exclusively mean the oil producing companies—have relied increasingly upon Rotterdam as an additional source of supply, and historically during the season the price differential has always been followed by the supply flow to the United States. But it hasn't been flowing this time.

We have a little graph to explain that. I do expect with the reversal—the little bars are imports, and you can see on the right-hand side of this graph, which depicts spot prices but also U.S. imports—you can see that imports have been as high as 450 thousand barrels per day in some weeks. I expect for the rest of January, by the way, imports to be in this range. I may be wrong, but I am almost confident of that.

But you see the reversal of the spot price differential, or the solid curve that should be everywhere below the broken curve is above the solid curve and substantially—40 cents—above. That has been a major detriment, and suddenly you have to look at disturbances abroad. The market at large—not just petroleum but everywhere—increasingly is becoming international, and price movements elsewhere affect us here.

Senator **Levin**. Well, just answer my question. Your personal opinion, then, is the futures market has been one of the incentives to reduce the preseason supply? That is the short answer, in your personal opinion?

Dr. **Merklein**. My personal view is that, if anything, it has tended to dampen inventories.

Senator **Levin**. Preseason?

Dr. **Merklein**. Yes, inventories generally.

Senator **Levin**. Thank you, Mr. Chairman.

Senator **Lieberman**. Just one final quick question and then a statement.

Dr. Merklein and Mr. Easton, in your personal views, do you think that unfair profits were made during December by anyone in the oil business—producers, refiners, or distributors?

Dr. **Merklein**. Well, it is probably not a good idea to venture personal views, but I frankly believe not. We had much of this kind of phenomenon occurring in April/May following the *Valdez* incident. The spot market behaved erratically and much was made of collusion. And I am sure that, during the gasoline crisis, then there was none. We have looked at this in some detail.

Here what you have is that the spot market price was accentuated by the fact that by the end of December the January futures market reverted into a prompt market, and an awful lot of people were left in short positions. They had to enter the spot market, and the process of their trying to cover their positions drove up the spot market price.

That is a timing coincidence to some extent, but the price in the absence of this phenomenon would not have risen quite as much. I am inclined to believe that probably there is no collusion, but again, I don't want to prejudge the study that we will do.

Senator LIEBERMAN. Mr. Easton, do you want to add anything?

Mr. EASTON. Mr. Chairman, we are still trying to, through the meetings and sessions we are having, figure out who the winners and losers were. We know the American public has been a severe loser in what we are all paying for our heating fuels, and we are trying to figure out now who the winners were. And it is just premature at this point to say that it was one segment or the other.

For example, we met with the president of the second largest propane company in the United States and found that during the last 4 months what they paid for rail tank cars had increased from $300 to $500 per lease payment up to $3,000. So here is a company that has got to move propane and instead of paying $300 they are paying now $3,000.

They also informed us that ships that chartered for $800,000 now have risen to $2 million. So we know there are a lot of segments along the way that are making more money, or appear to be making more money. We don't know why and we are trying to find out the answers to those.

Senator LIEBERMAN. Well, I certainly agree with you, and I think all of us do, that the American consumer was the loser during December. It is hard to feel comfortable with Dr. Merklein's personal conclusion—and I respect it as such—that there were not winners, when the data suggest that the price of crude oil only rose by 6 percent but the price that the refiners were charging rose by 78 percent.

You know, a couple of us yelled a little at Mr. Rill. And the truth is that his function is important, but it really takes place after the horses have left the barn. We have got to count on the Department of Energy to try to keep the horses in the barn, to do something to warn us when this is going to happen and help us to avoid it the next time around.

I hope you will consider some of the ideas that have been mentioned, in addition to the Jones Act waiver, such as the creation of a strategic petroleum reserve that could be pumped into the market when the inventories seem below demand. Following up on Senator Levin's question, I also hope that you take a look at the role of the Mercantile Exchange and consider whether a commodity as basic as oil should be subject to the kind of speculation that can occur on that kind of market.

Mr. EASTON. We don't want to leave you, Mr. Chairman, with the sense that all the Department is doing is looking at Jones Act waivers and thinking that will be sufficient. We are undertaking a national energy strategy at the moment in which many of these issues are being considered, such as regional reserves. The Department traditionally has found that regional reserves are not necessarily the answer, as we found that minimum operating levels or minimum inventory levels were not the answer back several years ago.

Our energy picture, our energy markets are changing. The fact that lower inventories are being kept causes us to reevaluate energy policy. Policy is not static, because the market conditions are not static. So we are looking at such things as—especially in the Northeast—increased energy supplies through pipelines. But you know there is public opposition in your own state to a new pipeline.

There are no refineries in the Northeast. A refinery might well be an answer to being able to deal with some of these situations. And if we are having problems getting refineries or pipelines built, will we have any easier time with regional petroleum reserves?

Nevertheless, we look at all these issues because we realize that you cannot make static, one time energy policy, it has to be a living, growing policy that meets the changes in the marketplace.

Senator LIEBERMAN. I agree. My sense is, from what you have all said to me, that inventories are going to continue to go down, which may mean that we will face this problem again, because Lord knows that the weather will probably get cold again.

I am afraid we have got to move on to the next panel. I thank you all for being here and for your testimony today.

We will now call Mr. Glenn Tilton, Charles DiBona and Robert Wesson.

Senator RUDMAN. Mr. Chairman, I would just like to ask that my statement be put in the record. I don't have to give the statement.

Senator LIEBERMAN. It certainly will, without objection, Senator. Thank you.

[The opening statement of Senator Rudman follows:]

OPENING STATEMENT OF SENATOR RUDMAN

I am deeply disturbed over the recent rapid escalation in home heating oil prices. As you know, prices for No. 2 home heating oil shot up in the month of December and early January throughout the U.S., with the highest price increases seen in the Northeast. In New Hampshire, retail customers saw their heating bills rise by over 60 percent. The average retail price of distillate was 91 cents a gallon on December 1. The price rose to over $1.50 per gallon on January 3, 1990. While retail dealers and suppliers argue that these rising prices are the result of the severe cold weather experienced across the country, driving up demand and tightening supply, in my view they have gone well beyond an adjustment for market fluctuations by charging captive consumers exorbitant prices for fuel.

I want to commend you, Mr. Chairman, for holding this hearing today. I know that your State of Connecticut has experienced the same problems as we have in the State of New Hampshire. I also know that our constituents want answers to the many questions surrounding this matter. I believe several important issues need to be addressed in this hearing:

What caused this sudden price escalation? This Committee needs to investigate all the causes and their related explanation.

Were refiners, wholesale suppliers and retail dealers price gouging and if so, who profited and by how much? The Department of Justice should investigate this matter to determine whether there was a violation of federal law with respect to price fixing. Price fixing is one thing and price gouging is quite another. I am convinced that there are a number of individual companies that profited immensely from this rise by charging consumers tremendously inflated prices.

Why were heating oil stocks so low going into the Winter months? According to the Energy Information Administration home heating oil supplies were 9 million barrels lower than last year at the start of the heating season, with stocks in the Northeast 7 million barrels lower. I hope that during this discussion, we will review the issue of creating a regional petroleum reserve in the Northeast.

What transportation and distribution problems hindered the ability to move supply and how can these problems be mitigated? I am very disturbed that the U.S. Customs Service was either unwilling or unable to grant more waivers of the Jones Act. According to the Department of Energy, two waivers were granted and seven are still outstanding. With a crisis of this magnitude, why would these waivers not be granted in a timely fashion? In light of these problems it may be necessary for Congress to consider altering either all or portions of the Jones Act.

Finally, at the peak of the crisis, the presence of timely price and supply information would have allowed governmental entities to react to the situation better by calming industry and consumer fears. It is obvious to me that federal data collection was inadequate and in my view needs to be beefed up.

Mr. Chairman, I am pleased to note your good judgement in inviting Larry Kelly, Director of the Tri-County Community Action Program in Berlin, New Hampshire to testify concerning the need for additional funding for low income home energy assistance. Mr. Kelly heads the community action program in New Hampshire which serves the North Country counties of Coos, Carroll and Grafton.

Mr. Kelly will likely tell you of the critical need for energy assistance in New Hampshire and throughout the entire New England region. As I am sure you are aware, Mr. Chairman, since fiscal year 1985 the federal appropriation for the Low Income Energy Assistance Program (LIHEAP) has been reduced by 34 percent. The recent heating oil crisis has proven that the funding level for this program is grossly inadequate. These budget cutbacks, coupled with falling temperatures, skyrocketing fuel prices and increased usage have placed programs such as the Tri-County CAP in crisis situations. In New Hampshire, over 2,000 additional households requested energy assistance over last year's level, an increase of 12 percent. The state has received over 86 percent of its LIHEAP allocation. At this rate, without additional funds, all allocated funds will be depleted well before the Winter months are over.

We simply must continue our efforts to ensure that adequate monies are available to meet emergency situations. I am hopeful that the fiscal year 1991 budget request for LIHEAP will reflect the urgent demand for this important safety net program.

These price increases have caused tremendous hardship on energy consumers across the country, particularly low income families and elderly on a fixed income. We have a responsibility to provide adequate energy assistance to those who most need it. We must also vigorously investigate the reason for this price escalation and take whatever appropriate steps are necessary to ensure that it does not happen in the future.

Senator LIEBERMAN. Gentlemen, I welcome you here. Again I want to restate my gratitude to you, Mr. DiBona. This is not the most pleasant appearance you will probably ever make, but I appreciate your forthrightness and your upholding your relationship with your consumers by coming forward. And I really do regret that the other oil companies that we asked to testify declined to do so.

I can tell you that I intend to discuss with the Chairman of this Committee, Senator Glenn, what steps we could take either to compel their appearance or at least to compel their response to written questions.

It is pretty hard to answer the question what happened without having some of the critical players, namely the oil companies, here.

With that introduction, Mr. Tilton, why don't you begin, representing Texaco.

Mr. TILTON. If we could, perhaps, Mr. Chairman, if Mr. DiBona could start he could give a broader perspective from API's aggregate view.

Senator LIEBERMAN. Fine. Mr. DiBona.

TESTIMONY OF CHARLES J. DIBONA, PRESIDENT, AMERICAN PETROLEUM INSTITUTE, WASHINGTON, DC [1]

Mr. DIBONA. Thank you, Mr. Chairman. I welcome this opportunity to discuss recent events in the heating oil market.

While API as a trade association is constrained by antitrust laws from being privy to pricing decisions, I believe I can shed light on important aspects of what happened, as we do collect overall supply, inventory and production statistics. And there is at least one mistake on that chart.

The central fact is that the petroleum industry managed, through extraordinary efforts, working their equipment and people to the absolute limit, to meet a surge in demand caused by a rare weather event that happens only once or twice in a century. The surge in demand in the Northeast called for as much as 50 percent more heating oil than in a normal December. Some companies in some states delivered several times their normal volumes.

This was accomplished in spite of the fact that an accident closed one of the largest U.S. refineries, that arctic conditions in the normally mild refinery centers froze piping, slowing output, that frozen waterways slowed barge traffic, and that exceptionally cold early conditions in Europe had diverted imports there in November.

The industry was called upon not only to supply an increased demand from regular heating oil customers of roughly 35 percent, but also to supply heating oils to electric utilities whose normal natural gas supplies were curtailed, and power companies, needing more fuel oil for electricity generation.

All this was done, and as far as we know, no individual or institution was without oil-based heat when it was needed. This unexpected and historic demand for oil not surprisingly caused prices to rise sharply. This had an undeniable and unfortunate impact on low income consumers, and we agree that that problem needs attention.

But as prices rose, companies across the Nation were able to make sure that demand for heating oil was met. That is because oil companies had to take extraordinary measures to produce and move supplies at extraordinary costs. The higher prices both gave incentive and made possible actions that would ordinarily be too costly to undertake in this highly competitive market. Refineries were run to their limit and the mix of products altered to produce more heating oils. Nearly every clean product barge and tanker available in the gulf coast was chartered in the sellers market when the Colonial Pipeline was full to capacity.

Expensive trucks transportation was heavily used on overtime and on long emergency trips to shift product to terminals that were running dry. The people in the system worked overtime, including Christmas eve and New Year's. Stocks, which are often being built in December, were drawn down at times at the rate of 20 million gallons a day. Kerosene jet fuel was mixed with heating oil to keep it fluid in the frigid weather, and those stocks were also drawn down.

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[1] See p. 200 for Mr. DiBona's prepared statement.

Companies bid for imported oil at very high prices, drawing more of it away from the also cold European market. The imports were desperately needed to refill the stocks being depleted. These imports are arriving now and will continue to arrive. There is, of course, no assurance they can be sold at prices high enough to recover their cost, as the spot market is now falling sharply.

That brings me to the question of profits. Despite the increased costs involved in meeting the extraordinary demand, profits probably rose, just as they fall during a glut. But there has been considerable confusion in the media over what are profits, and it is carried forward in this chart on the left.

Much of the discussion during this period has focused on refinery or retail margins. They are not profits. Before profits earned, capital investment, refinery expenses, crude oil transportation costs, product transportation costs, equipment maintenance and repair, and other product related costs must be subtracted. And many of these undoubtedly rose sharply in December. And furthermore, the barrel of crude is not made into 100 percent heating oil. In fact, the maximum is about 25 percent heating oil.

Nevertheless, industry profits probably went up. Yet this is not a particularly profitable industry. While I do not have information for the last quarter of '89, I can tell you that between 1984 and '88, and also for the first 3 quarters of '89, the 20 leading U.S. companies made a lower annual rate of return on their investment than did nonpetroleum manufacturing companies generally.

The simple fact is that the oil industry is highly competitive, cannot set prices to assure high profits. Prices and profit levels instead are set by market forces of supply and demand. In sum, it is clear that the petroleum companies over the past several weeks did much more than simply take in profits. They reacted to an extraordinary situation with extraordinary activity, and heating oil customers and consumers were kept supplied throughout.

Thank you. I would be happy to take any questions, but I would add that in this I didn't have in the 5 minutes time to get into the inventory situation. But I would be happy to discuss that at length because I think there is some history about that that you ought to be aware of, and some implication of the level that we ended December with.

Senator LIEBERMAN. I am sure we will ask you about that.

Mr. Tilton.

TESTIMONY OF GLENN F. TILTON, PRESIDENT, TEXACO REFINING AND MARKETING, HOUSTON, TX [1]

Mr. TILTON. Thank you, Mr. Chairman.

Mindful of the importance of the red light and the cautionary yellow light, perhaps I could borrow a little bit of time from my absent colleagues.

My name is Glenn Tilton and I am the President of Texaco Refining and Marketing, Inc. Texaco's affiliate, Star Enterprise, has approximately a 7.5 percent share of the heating oil market in the Northeast. This would place us about fourth on the list of suppliers in the Northeast.

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[1] See p. 218 for Mr. Tilton's prepared statement.

We refine crude oil and heating oil and other products and we market them. In many places we sell in bulk to large independent terminal operators who in turn sell to heating oil distributors, who then sell to residential customers.

We also purchase heating oil for resale from other refiners, or from importers or from traders. Only about 7 percent of our 7.5 percent is actually sold directly to consumers by Star Enterprise.

In a changing market whether prices are rising or prices are falling, we make literally thousands of complex purchase, resale and exchange transactions in any given period. The pervasive question being asked today by the public at this time is quite simply, why did the price of heating oil go up so dramatically?

While we recognize that this is both an obvious and understandable question, we think it is equally important to ask two perhaps less obvious questions: Why was demand for heating oil so high? And what factors impacted the industries and our company's ability to supply that demand?

To restate very briefly, the weather in the Northeastern United States during December averaged 30 percent colder than normal. This icy cold, coupled with freezing rain and snow, penetrated as far south as Texas and Florida, causing operating problems in many gulf coast refineries, which are a prime source of home heating oil for the Northeast.

As a personal example, the morning low temperature at my home in Houston was 7 degrees Fahrenheit on December 23rd. Plumbers were having a heyday. The average low temperature on December 23rd in Houston is 42 degrees. The December 24th explosion at Exxon's Baton Rouge, Louisiana refinery resulted in the loss of 2.5 billion barrels of production over a 10-day period.

When coupled with, as we have heard, increased demand for distillate in Europe, additional strains were placed on the United States heating oil supply situation. The severe cold weather caused disruptions at refinery operations in many locations, and the transportation system upon which we rely for the delivery of heating oil.

Finally, there is no excess capacity in the United States refining system to cover large surges in demand. Even with record heating oil production of 3.4 million barrels per day for the week ending December 15, a large increase in imports was required to meet demand.

Demand for heating fuels increased by some 25 to 30 percent nationally during the period, increases estimated as high as 50 percent in the Northeast. These conditions intensified the tight supply situation in areas other than New England, and required purchases outside of normal supply channels, including foreign markets, which were already experiencing a tightening of supply and increased demand in their markets.

All of these elements contributed to an increase in the price of heating oil. For example, the price of No. 2 heating oil on the New York Mercantile Exchange increased 70 percent from November 27 to December 29, for shipment to New York Harbor. As we prepared for the 1989-1990 home heating season, mindful that our normal demand was 187 million gallons of heating oil during an average winter, we believe our inventory position going into this winter season was adequate to meet those projected demands.

Larger inventories than required created significant additional costs for our customers. To be more specific, in stark contrast to our projected demand for home heating oil in December of 1989, we delivered and sold 91 million gallons, an increase of 54 percent over the same period in 1988. Some 41 million gallons of that product had to be purchased by our company on the open market, where sudden and drastic price increases were taking place as a result of heating oil suppliers, both in the United States and internationally, competing for the same barrel of product.

If we had not been willing to pay increased price levels, we would not have been able to keep our customers in the Northeast supplied. In fact, from December 23rd to December 30th we purchased 24 million gallons of heating oil at an average price of 95 cents for our customers in the Northeast. Much of that product has not yet worked its way through our system, and with current prices in the range of 76 to 86 cents per gallon, we stand to suffer a loss on those purchased barrels.

Not surprisingly, no one has expressed concern over the possibility that we may have to sell product for less than its purchase price, and that is all right. We accept the risk inherent in the free market. Higher prices are never popular, but they are far preferable to the personal and economic hardship that would occur with a failure to supply it. We were able to supply all of our regular customers with heating oil during the cold spell in the Northeast. In fact, our truck drivers, our terminal operating personnel, our dispatchers and other support people regularly worked double shifts, including weekends and holidays, to ensure the product was delivered where it was most needed. Unfortunately, our delivery drivers regularly reported stops at homes where as little as 25 gallons of heating oil was needed to fill a 250 or 300 gallon tank.

Yes, heating oil was more expensive in December than in October or November. While it was more expensive, it was available because the price rise attracted supplies from outside of this region.

A major goal of our company is to establish a solid reputation with our customers, to provide reliable products and service at a fair price. We value our customers. We recognize they have alternate supply opportunities. We have long-standing business relationships with our customers which we would not jeopardize for short term gain.

To fully understand and appreciate the working of a competitive marketplace one need only look at the current supply/demand price relationship. With temperatures returning to more normal levels and demand falling, the price of heating oil has dropped. In the first 10 days of January in the wholesale and futures market, the New York Harbor price for No. 2 heating oil has dropped by 18 cents, to about 73.5 cents per gallon. The futures prices for February delivery on the NYMEX have dropped by about 12 cents, and I note that they dropped 5 cents yesterday.

When competitive markets are operating freely consumer needs are met at the lowest cost. Although there is a strong temptation to interfere with the workings of the free market during a period of rising prices, we have seen in the past how allocation systems, rationing or price controls have exacerbated shortages, increased prices and resulted in inequities greater than those under a competitive market.

I sincerely hope that we have been able to shed some light on the experience of only one company during this extraordinary period in the month of December. I thank you for your attention and giving me this opportunity to share the information with you, and, of course, I will be glad to answer questions.

Senator LIEBERMAN. Thank you, Mr. Tilton.

Mr. Wesson, we welcome you, representing the petroleum marketers, the people who deliver the oil to us at our homes and businesses. I particularly welcome you from Waterbury, Connecticut.

TESTIMONY OF ROBERT W. WESSON, PRESIDENT, WILLIAM S. WESSON, INC., WATERBURY, CT, APPEARING ON BEHALF OF PETROLEUM MARKETERS ASSOCIATION OF AMERICA [1]

Mr. WESSON. Thank you, Mr. Chairman.

My name is Robert Wesson, and I am a heating oil dealer from Waterbury, Connecticut. I am appearing today on behalf of the Petroleum Marketers Association of America and the New England Fuel Institute, trade associations that represent nearly 11,000 small marketers throughout the country.

Perhaps the best description I can offer as to how heating oil retailers feel after the events of the last 6 weeks is whip-sawed. They have been whip-sawed by their suppliers with tremendous price increases which we don't understand and cannot explain. And on the other side we have been whip-sawed by our customers, who are justifiably angry and who are asking what's going on. Unfortunately, we have been in a poor position to answer that question since as retailers we probably have as many questions about what went on as do members of this Committee.

What I do know is what is happening in my own business. From the middle of November to the end of December my average wholesale costs of fuel increased from 63 cents per gallon to $1.22 per gallon. During that same period my retail price to my customers increased by 47 cents. The difference, 12 cents, is what I absorbed of the wholesale price increases. I also absorbed a considerable amount of additional operating costs as a result of increased overtime paid to my drivers, dispatchers and other employees, increased transportation costs, and the inability to obtain supply through normal distribution procedures.

Data published by the States of Connecticut, New York and New Jersey show that my experience is not unique. In those States retailers also seem to have absorbed 8 to 10 cents per gallon of wholesale increases, as well as their own operating costs.

I suppose the most positive thing I can say about the whole situation is that the oil heat industry continued its outstanding record of ensuring that all customers received adequate supply despite some substantial logistical problems faced by retailers. Let me briefly discuss two of those problems.

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[1] See p. 232 for Mr. Wesson's prepared statement.

First, our suppliers developed conflicting means of allocating supply. One supplier told my company that in December we could purchase 120 percent of what we purchased in December of 1988. The only problem with that message was that it was not delivered until December 20th, well after the time that many distributors had already purchased 120 percent of their 1988 volumes. As a result, many marketers lost a prime source of supply for the last 10 days of December.

Another supplier implemented a program whereby they agreed to sell so much product from a given terminal on a given day and they then would close the terminal. The only way a marketer could receive supply he had contracted for was to get there before that supplier sold the designated volumes.

Yet another supplier allowed marketers to pull only one load of product a day from the terminal. As a result of all these problems, it was not unusual for a marketer to have his trucks literally driving from terminal to terminal in search of product.

A second problem came from the sudden surge in demand for oil from nontraditional oil users. For the most part, these users are interruptible natural gas customers whose supply had been shut off. Dumping them in the oil market created an unanticipated surge in demand which affected both the price and supply of fuel.

The ultimate question, however, is what can be done to avoid a repeat of the enormous price spike which occurred in December. We believe there are some steps which can be taken which maintain our reliance on marketplace principles but which lessen our vulnerability to a repeat of December.

First, there should be put in place a regional product reserve as part of the strategic petroleum reserve, which could be drawn down in the event of an emergency. Had such a reserve been in place in this instance it could have stabilized considerably the supply/demand imbalance which existed.

There has been much debate over the level of inventories that existed as we enter the heating season. Certainly these levels did not match last year's, but the reality is that the legal of inventories in any of the last 5 years would have been insufficient to deal with the type of bitter early winter we encountered this year.

The second recommendation I would make is to urge your reexamination of the policy by which we allow natural gas utilities to aggressively sign up new customers and then dump part of their less desirable customer base into the oil market during the coldest months of the year. Utilities should be held accountable for these customers the year round, and until they are they should be limited in their ability to sign up new accounts. Otherwise residential oil users are forced to subsidize such policy.

In addition, if interruptible customers are going to be allowed, there should be some policy direction regarding the amount of oil storage capacity they must maintain. The lack of adequate storage by large interruptible customers means that oil deliveries to them must be done frequently, oftentimes interrupting the normal distribution patterns a company may have.

The third recommendation is that there be an immediate supplemental appropriation for low income energy assistance programs. No one could have foreseen the type of winter we have experienced, not the industry, and certainly not the Congress or the President when the appropriation for the low income energy assistance program was approved. Therefore, an urgent supplemental appropriation is required.

Thank you for the opportunity to appear. I would be very happy to respond to any questions.

Senator LIEBERMAN. Thank you, Mr. Wesson. Thank you all.

I am honored to welcome Senator John Glenn, the Chairman of the Committee, and to restate in his presence my gratitude to him for authorizing me to conduct this hearing. Without his support, the important questions that we are asking today would not be asked.

Thank you, Senator Glenn.

I would like to begin the questioning. I will go a round.

Mr. DiBona, in your testimony you repeated some thoughts that I believe Mr. Merklein expressed earlier. While you are not quite poor-mouthing, you suggested that the oil industry has not been doing well in recent years. And that stretches my cred—what is the word I'm looking for? I don't believe it, is what I am trying to say.

Chairman GLENN. Credulity.

Senator LIEBERMAN. Credulity, right. Has any major oil company lost money in recent years?

Mr. DIBONA. On a year-to-year basis or quarter-to-quarter basis—I don't happen to have the quarter-to-quarter figures for every single company. I happen to have the individual company figures for 1988, and 1989 for the first 9 months, and I have the total of all—a sample of API companies.

Senator LIEBERMAN. What do you find? Has anybody lost money in that time?

Mr. DIBONA. No, but just let me give you the figures. This is net income percent of stockholders equity. The API sample of companies in 1984 was 11 percent return, and for nonpetroleum manufacturing, 14.8. For '85 it was 10.3 versus 11. For '86 it was 3.7 percent versus 12 for other companies. For 1987 it was 6.3 percent versus 15.5 for nonpetroleum manufacturing. And for '88 it was 14.9 for the petroleum companies, 16.9 for the nonpetroleum. And for the first 9 months—the fourth quarter figures are not in—for——

Senator LIEBERMAN. Let me, if I may, with apologies——

Mr. DIBONA [continuing]. 13.9 versus 16 percent for nonpetroleum.

Senator LIEBERMAN. Let me just interrupt. Those are percentages, and I hear them. But isn't it true in absolute terms that the industry is still making hundreds of millions of dollars? Billions?

Mr. DIBONA. Well, if you mean it is a very large industry that sells a great many products, a great volume of products, then that is true. But the rate of return on stockholders' equity is normally the accepted method of determining the profitability.

Senator LIEBERMAN. I understand.

Mr. DIBONA. What it really reflects is that undoubtedly in periods of shortage profits rise and in periods of glut they fall. But on average they are not extraordinarily profitable enterprises.

Senator LIEBERMAN. Well, that stretches my credulity, to get the word correctly.

Mr. Tilton, how did Texaco do during——

Mr. TILTON. Mr. Chairman——

Senator LIEBERMAN. If you could give it to me in absolute dollar numbers, which is what most of us understand.

Mr. TILTON. Less than 2 cents a gallon.

Senator LIEBERMAN. Your profit is less than 2 cents a gallon?

Mr. TILTON. That is correct.

Senator LIEBERMAN. And overall how much did Texaco make in gross numbers? I'm looking for net income.

Mr. TILTON. We haven't declared the numbers for the year yet, sir.

Senator LIEBERMAN. What would you guess?

Mr. TILTON. Mr. Chairman, I would say that perhaps for the consumer that does put it in the appropriate perspective. We will net less than 2 cents for all gallons of product sold by our company, by Texaco, Inc., in the calendar year 1989.

Since we are talking about gallons as we walk through the discussion of what happened in December, we will make about that amount of money in the marketing of the products that are being discussed here today for the month of December.

Senator LIEBERMAN. But you are selling a lot of gallons, aren't you?

Mr. TILTON. Well, yes, sir.

Senator LIEBERMAN. In other words, I am asking a simple question. You are the president, give me a ballpark estimate of how much money in absolute dollars you think the company made in the first 9 months of 1989? That's before we got into this price spike.

Mr. TILTON. Well, it is a matter of public record and really don't—I would rather not speculate on what the number was.

Senator LIEBERMAN. You don't know it? You can't call it up?

Mr. TILTON. We are talking about a number in excess of a billion dollars for the year for all of Texaco, Inc., which is a worldwide global company.

Senator LIEBERMAN. That is a net income level?

Mr. TILTON. That is correct.

Senator LIEBERMAN. I don't mean to belabor this, but I do want to make the point that, while you may not have the high profits you had in earlier times, this is still a very profitable industry, if one company is making over a billion dollars and some others are making more than that. So I think you come before us not exactly in bad condition.

Mr. TILTON. Well, I think it is important to understand the different segments of the business, Mr. Chairman. The profitability in 1989 has largely been in the exploration and producing segment of the international oil business. Refining and marketing business in the United States is not a particularly attractive business into which to invest new capital. Our rate of return in 1989 on refining and marketing in the United States is going to be significantly below 10 percent. It is going to be at about the passbook savings level. It is not attracting waves of new investment. A significant amount of new investment going into our refineries, Mr. Chairman, in the United States are going to be dedicated to environmental investments.

Senator LIEBERMAN. Well, my time is up on this round. But again, I understand when you say 10 percent and you talk about passbook earnings, that is one set of vocabulary terms. For the average person who paid an enormous amount of extra money for heating oil and propane during December and reached real deep down in their pockets to do so, or maybe found nothing in their pockets, a 10-percent rate of return sounds pretty good.

I am going to yield now to Senator Cohen, but I will be back.

Senator COHEN. Mr. Chairman, it just struck me, as you were saying, Mr. Tilton, only 2 cents a gallon. I recall Art Buchwald's suit against Paramount where a movie grossed $300 million but there was no profit. It just struck that we are talking about a fairly significant amount of money. Even though it is a low margin on a gallon, high volume still produces a significant return for the industry.

Mr. TILTON. I would question, Senator, whether it is a high volume return. I think that there is a significant cash flow associated with the business, that's correct.

Senator COHEN. Could you tell, either Mr. Tilton or Mr. DiBona, how many companies have merged or have been bought out during the past 10 years, oil companies?

Mr. DIBONA. I don't really know.

Senator COHEN. Is it a high concentration over the past 10 years? We are talking about 19 major companies that remain.

Mr. DIBONA. Yes, I think that it is correct to say that there is no single company in the United States that has 10 percent of the market in any major fuel, and I think it is—and I know it is correct, what economists look at, which is the degree of concentration, which is generally a 3 or 4 company—percentage of the market held by 3 or 4 companies, it has probably the lowest concentration of any large industry dealing in a basic commodity. So it is a highly decentralized industry in which in just about every market it has a very small what are called concentration——

Senator COHEN. I will ask you for the record, not now, but to perhaps break it down for us—

Mr. DIBONA. Sure, We would be happy to provide that

Senator COHEN [continuing]. If the market is controlled by six companies, let's say, or the 10 largest, or——

Mr. DIBONA. We would be happy to give you the figures on that and give you a comparison with other major industries.[1]

Senator COHEN. Senator Levin was asking a question of the DOE about minimum inventory levels, and DOE doesn't set any minimum inventory levels. But the industry sets minimum inventory levels, does it not? Don't you have a certain minimum that you maintain?

Mr. DIBONA. No, we do not set inventory levels. What was done was a study was conducted under the auspices of the National Petroleum Council to determine what would be the minimum operating level, and in the case of heating oil—rather, in the case of these distillates, middle distillates, it was 85 million barrels.

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[1] See p. 212. The market report referred to may be found in the Committee files.

You should understand that in this market there has been a decline in the fraction of the market that goes to heating oil. The great bulk of the sales of middle distillates, which are what these numbers are about, go to diesel, on-road and off-road diesel operations.

So today only about a quarter of that market goes into heating oil. Because diesel consumption is approximately the same in winter as in the summer, the need for large winter stocks has declined. And that is part of the reason that you see the secular decline. That 134, incidentally, is a wrong number. That should be 128 in 1987.

In the Northeast, which is the figure you ought to be looking at, because a good part of the problem here was moving these stocks. What happened is the front end of this system got sucked out by the sudden demand, and unexpected demand, in heating oil, and the problem was to push supplies into it. Those supplies were in various places, but it was very hard to get them there. And in this year there were 52 million barrels in stock on the East Coast. The year before there were 54, and the year before that 52 million. So in terms of the stock available for this purpose, there really hasn't been any significant change.

I might also add that the production levels were not significantly for the quarter above the production levels of last year, which was asserted before the last hearing. The production is up roughly equal to the increase in demand, principally coming from diesel fuel, which is chemically the same as this other fuel and carried in the same stocks.

Senator COHEN. If I could just finish up with one question in this round, Mr. Chairman.

Mr. Tilton, you indicate that one of the factors that had an impact on the shortage—well, there were many. There was the tremendous cold snap, which is unanticipated. There was low traffic or tied up traffic on the Rhine because of low levels of water. You also cited the refinery blast in Louisiana as one factor.

And I was a bit confused about that, to tell you the truth. I am looking at the Oil Daily, December 24th of last year, and on one item it says, headline, "Refinery blast, frigid weather bolster rise in heating oil prices," and the story line is "Heating oil prices skyrocketed on the Mercantile on Tuesday in response to an explosion at the Nation's second biggest refinery." That is one story. The second story is over here on the left. It says, "Little short-term impact from blast, Exxon says. Exxon says its ability to supply contracted volumes of heating oil is not hampered by an explosion and fire that left one worker dead," et cetera. Which one is accurate?

Mr. TILTON. Both. I would say that the Mercantile Exchange and the proactive nature of the Mercantile Exchange in setting price for distillate has introduced, unquestionably, a level of volatility into the price mechanism for the product. I am sure you gentlemen know that price moves energetically all day long in any given trading day. As we have seen here recently, 5 cents yesterday, as a matter of fact, for February delivery, which is a consequential change.

So the psychology of the event creates movement on the Mercantile Exchange, irrespective of the reality that is sorted out a little later on. With respect to Exxon's statement, frankly, I can only speculate as to what the manager quoted meant. What I presume he meant was something similar to our situation. We honored our contractual obligation to our customers by going into the market to purchase product for their account, regardless of price.

Our feeling has always been that there are ample supplies in the marketplace to be able to do so so that we can meet Mr. Wesson's requirements. And that is exactly what we did, and I am sure that that is what Exxon thought they were going to do, and I am sure that is—I frankly believe that is what he intended to say.

Senator COHEN. But basically it was the speculators on the Mercantile that decided that this explosion was going to create a shortage?

Mr. TILTON. I think it is a sense of what the result is going to be, whether or not that actually happened as the market takes stock of what the result is going to be in any given event. We could say low water on the Rhine, frankly, Senator Cohen, is the same type of situation. That information reaches the East Coast of the United States. It has an inevitable effect on the presumption of value for the distillate on the Mercantile Exchange.

Mr. DIBONA. Actually, two things happened in that week. One of them was the explosion. The other was that the refineries which had been running at tremendous rates during the first 3 weeks in December, many of them ran into freezing conditions and as a consequence the total runs through the refineries in that week fell by 1.6 million barrels a day, according to the API statistical collection. And it was a combination of those two factors. We were running hard enough in the first 3 weeks to have the biggest distillate production we have had since 1978.

Senator COHEN. If I could just have one clarification of a statement that you made. I think you indicated that the stocks, or the inventory and supply was 57 million barrels as compared to either 56 million the year before?

Mr. DIBONA. No. It was 52 million on the East Coast in 1987, 54 million in 1988, and 52 million in 1989, on the East Coast.

Senator COHEN. So there was a drop between '89 and '88?

Mr. DIBONA. Yes. It was the same as '87. But you are talking about 4 percent differences in the stocks.

Senator COHEN. Because some of the figures that we have heard coming from the Maine State Planning Agency, for example, would indicate that there may have been as much as a 25 percent drop in available stocks.

Mr. DIBONA. We do not keep—these stock figures and the stock figures that the API collects are figures in primary storage. We do not know what an independent distributor is or is not holding, and we have no knowledge of that. So on top of these stocks are independent distributor stocks, and those could vary. These are the primary stocks held principally by refiners in large terminals.

A thing you should remember is that we ended December with about 108 million barrels. We were drawing down during December an average of 435,000 barrels a day. That is about 17 or 18 million gallons a day. We could have continued to do that for another 60 or 70 days before we came to the 85 million minimum operating level. So we could have continued for another few months. That would have been a very hazardous and unnerving thing to do, and it would have incurred immense costs as you were trying to move this stock around to kind of meet people's demands.

And undoubtedly people would have been very much into European and spot market to try and replace that stock. But we could have continued to do that.

Senator **LIEBERMAN**. Thank you, Senator Cohen.

Chairman Glenn.

Chairman **GLENN**. Thank you, Mr. Chairman.

I have an opening statement that I would like to have inserted in the record.

Senator **LIEBERMAN**. Without objection, the opening statement of Senator Glenn will be made a part of the record.

[The opening statement of Senator Glenn follows:]

OPENING STATEMENT OF SENATOR GLENN

This morning the Governmental Affairs Committee will hold hearings which will examine the recent jump in home oil heating cost.

Senator Lieberman, as well as other Senators on the Committee, have demonstrated an interest in learning more about the implications of the escalation in the jump in home heating oil, particularly in the northeastern section of this country. As temperatures went down in December, oil heating prices went up.

As cold weather spread across the country, the demand for oil to heat homes and workplaces also increased. Were the increases in cost justified? Did distributors raise their prices too high in anticipation of future price increases? What was the "ripple" effect of the oil increase on other forms of fuel? Finally what are the long term implications of the recent home heating oil increase?

These are questions which I am sure that Senator Lieberman and the committee will explore during the conduct of these hearings. Obviously, the segment of our population which is hardest hit in a crisis of this kind is usually those persons who can least afford any deviation in their budget. The elderly on fixed income, the working poor who have to choose between being warm and being fed and the most vulnerable of all, children in low income homes who routinely are asked to sacrifice in the face of any crisis.

I commend Senator Lieberman for his interest in this issue and for the prompt manner in whch he brought this subject before this Committee and the Senate.

Chairman **GLENN**. I just want to congratulate you on your efforts to set this up this morning and bring to the public forum the problems that are occurring in the home heating oil pricing situation.

It hit a lot of people hard enough so that it is a question of whether they are going to heat or eat, the people that don't have much income to begin with. That is the reason there is such concern, and so I am glad you are having this hearing and I was glad to go along with you on it.

Also let me say as far as the industry goes, I think usually you figure that a return on investment is a fair way of measuring a business, and you do have huge investments, I know that. But it is at the same time very difficult to look at something like the rise that has occurred and not have very serious questions about it.

I guess my first question would be is the supply now caught up? What percent of catch-up have we done? Mr. Tilton or Mr. DiBona, anybody?

Mr. **TILTON**. I will be glad to speak for our company. Mr. DiBona will have to speak for the industry.

Mr. **DIBONA**. Well, currently we have 108 million barrels in stock. The weather is quite warm. The demand has dropped significantly. The refineries are back up running. The freeze is over down in the south, and the Exxon refinery is back on line, not I guess quite up to its former capacity, but pretty much on line.

So there is really no reason to fear a problem for the next few months. One of the difficulties for operators will be that they will be receiving supplies now that were bought to refill these inventories on the spot market in the last couple of months that will have been bought at much higher prices than the current spot market. And so that will—but they will be here. They are arriving and the level of imports was going up in the last few weeks of December and the first week of January, so it is clearly on the rise and we assume that would continue.

You have to remember that this was a once in, or twice a century event. This is an event which will occur only once or twice in a century. The last time it occurred was in 1917 when you had weather conditions like this in December. So when you think about the way in which you should prepare for that, you should be very careful. It probably does not make any sense—I am sure it makes no sense to provide stocks against that kind of eventuality. It makes much more sense to just make the system work very hard to deal with those problems.

Chairman GLENN. What were the price increases from the first of December to the last of December? I believe our previous panel indicated they were on the order of a 70 percent increase; is that about correct?

Mr. DIBONA. If you take the New York spot, and these are what, again, In November was 60 cents and on January 5th it was 92, and I think that it peaked at about $1.15. I think it was a very short peak of that, but you probably know these figures.

Chairman GLENN. Can we expect the prices to come down as rapidly as they went up?

Mr. DIBONA. Well, they have come down very sharply. They are down—well, this morning, they fell again, as I understand it. The futures markets were open yesterday and they fell 5 cents and they are down in the 1970's——

Mr. TILTON. They fell 3 cents yesterday, Senator.

Chairman GLENN. We always seem to have a rapid price rise when there is a shortage, it goes straight up in the air immediately and people get hit right in the neck immediately and it takes a long time, if ever, to get back down to where it was before. Why the big delay?

Mr. TILTON. Perhaps, Senator, I could shed a little light on that. We purchased those 41 million gallons to satisfy the requirements demand of our customers to make sure that nobody ran out of fuel by the Texaco system or the Star Enterprise System. We paid 95 cents for those gallons. They are now in the system.

We are mindful that, as we sold those gallons out to the distributors and wholesalers and retailers of the product, they are going to come down grudgingly, because they are now a cost of that inventory. And to the extent that we can, Senator, against a 60-odd-cent value today, there is going to be some attempt to capture that 30-cent differential between the purchase price and the current realization price.

To get back to your former question, Senator, we experienced a 54 percent run-up in demand in December, in one month. We prepared our inventories to cover an entire heating season over the span of the winter. We purchased product to cover that run-up in demand in the month of December and we find ourselves in good stead to cover our inventory obligations for the balance of the heating season.

Chairman GLENN. Just one further question. We are in near spring-like weather here today.

Mr. TILTON. Yes, sir.

Chairman GLENN. So, the demand is going to be down and that extends up through the New England States, where the impact has been heavy. But what happens if we get right out of this into another freeze like we had in December? Are we set to cope with that, or will we see prices double or triple again right off the bat all over again? What happens when we go back into a February cold spell, which is not unusual at all? It is also out of the norm for this century or two centuries or whatever. Are we going to triple again, or are our inventories now being kept at a level that is going to protect us against that?

Mr. TILTON. Senator, one can only speculate, but it would be my sense of the situation that the inventories, working our way all the way back to our company, are rather full. I expect that since the consumption of the product is not going to be significantly between now and the next cold snap, the supplies will be ample.

Chairman GLENN. But would we expect a rise again like we saw before, if we have an unusual cold snap?

Mr. TILTON. Given the description of the events——

Chairman GLENN. Are prices going to go up again like they did before and be reflected, then, in a re-tripling again over what we have already had?

Mr. TILTON. It would again be speculation on my part, but I doubt that we will ever see the convergence of events that we saw in December for the foreseeable future.

Chairman GLENN. I hope you are right.

Mr. TILTON. I hope I am, too, Senator.

Senator LIEBERMAN. Thank you, Senator.

Senator Rudman?

Senator RUDMAN. Mr. Tilton, we are glad you are here.

Mr. TILTON. I am delighted to be here, Senator.

Senator RUDMAN. You are about the only——

Senator LIEBERMAN. I would suggest you not answer that question before you hear Senator Rudman's question. [Laughter.]

Mr. TILTON. I will reserve judgment on that, Senator.

Senator RUDMAN. We are glad you are here, because you appeared voluntarily and I prefer that people come voluntarily and we not issue subpoenas. But you are here voluntarily and your statement is an interesting statement.

One of the things that I looked at here is that you say in your draft statement or in your other statement, that about 41 million gallons of the product had to be purchased by your company to fill the market, out of a total of 91 million gallons. That is obviously more than half.

You know, the real question here is one of curiosity, like of inquiring minds would like to know, you know, who made all the money here. I mean, as I point out to the Assistant Attorney General from the Justice Department, there is no law against price gouging. Our constituents do not like it, we do not like it, but, you know, if people want to price gouge, whoever they are, so far, unless it is a regulated utility who cannot do that, antitrust, of course, is far different and we will look into that.

But the question I have is this: What did you pay for some of this product during this time you had a glut in the market? I mean what was——

Mr. TILTON. An average of 95 cents, Senator.

Senator RUDMAN. That is what you paid for it——

Mr. TILTON. Yes, sir.

Senator RUDMAN [continuing]. An average of 95 cents?

Mr. TILTON. Yes, sir.

Senator RUDMAN. What would you have paid for that 6 weeks before?

Mr. TILTON. I would hazard a guess around 55 cents.

Senator RUDMAN. So, you have had an increase——

Mr. TILTON. That is correct.

Senator RUDMAN [continuing]. Of that much?

Mr. TILTON. Yes, sir.

Senator RUDMAN. And of the product that you didn't have to purchase, what was that booked at in inventory value?

Mr. TILTON. I think it's inventory value going into the year would have been an approximation of the number that Mr. DiBona shared with us, on average, 60-odd-cents, in the low sixties.

Senator RUDMAN. So, to the extent that you sold your old inventory, you made a much higher than average profit on that?

Mr. TILTON. In answer to your question——

Senator RUDMAN. First answer that, is that right?

Mr. TILTON. Yes, that would be correct.

Senator RUDMAN. Okay. So, on the 45 or 50 million gallons or whatever the difference is, I guess it comes to about 37 million actually, 37 million gallons of old inventory, you made a much larger than normal profit on the 54 million——

Mr. TILTON. No, sir, that is not entirely true. Keep in mind that we sold it over the period of 31 days of December. We didn't experience this escalation in price until the latter part of December, so we were selling those volumes on a ratable basis into the market that we serve, they were being lifted in the first two weeks of December at a reasonable price. It was not until, frankly, we ran upon the spike as it has been described here in the latter two weeks of December, that those margins began to run up significantly.

The only way for somebody to have made the money that we are looking for here is that, had you sold nothing but your equity production and had you sold it in the second two weeks of December and sold very little in the first two weeks of December, and you experienced no extraordinary costs of operation associated with the process, you would have made a lot of money. I frankly don't know that anybody did that.

Senator RUDMAN. But your testimony is that what you had in inventory at the beginning of that period, you were moving out at what was then the base price, let's say, up in New Hampshire of 90-95 cents a gallon, whatever it was at that time, you were selling it at that price or a little bit more and that it kept rising, but by the time the big spike came, you were buying this 41 million gallons?

Mr. TILTON. No. No, sir.

Senator RUDMAN. That's not the fact?

Mr. TILTON. No. We sell to the entire Northeast, but we sell relatively little in the State of New Hampshire. We sell in the State of Pennsylvania. As a matter of fact, as a matter of interest, our equity production out of the Delaware City Refinery and the Louisiana Refinery does not meet the rigid sulfur specifications in the Northeast, so our equity supplies move elsewhere. We exchanged product available in the Northeast. Those product supplies go either West or they stay South.

Senator RUDMAN. Your testimony, then, if I understand it, is that since you purchased an enormous amount of this because of the nature of the other inventory, when it was sold, that your margins during the period were normal margins?

Mr. TILTON. That's correct. When we close the books on December, Senator, we will realize a profit no greater than the profit for the enterprise in November.

Senator RUDMAN. It will be about the same for the 2 months?

Mr. TILTON. That's correct, yes, sir.

Senator RUDMAN. Let me ask you this, then: Who made these huge profits, the owners of these cargoes that were coming from various places, foreign operators and so forth?

Mr. TILTON. I would——

Senator RUDMAN. You are in the industry, you are——

Mr. TILTON. Mr. Rudman, I would advise against trying to categorize the segment who made the money. I would say that the participant in the process that was in the right place at the right time, with the right cargo, having purchased it at the right price and had occasion to sell it to me at 95 cents made some money.

Senator RUDMAN. But those, you are telling me, were surely not your company and probably not the other majors, the other majors would have to go on the spot market and purchase also, is that your belief?

Mr. TILTON. For those of us that have an obligation, both contractual and otherwise, to supply regional customers, that's correct, yes, sir.

Mr. DIBONA. Well, there is another thing that happened, Senator, and that is a good part of the fuel that is sold during the winter comes out of current production.

Senator RUDMAN. I understand.

Mr. DIBONA. It is not a draw-down on inventory——

Senator RUDMAN. I understand.

Mr. DIBONA [continuing]. Built up at a previous time. A number of things happened in order to try to get this fuel up to the Northeast. One of them is that prior to the time of the freeze-up of the refineries, they were running larger volumes of crude oil and they were running a larger fraction of the crude oil into heating oil. That involves substantially increased costs. The costs that you incurred in October and November to produce heating oil were not the costs that were being incurred later in December to try and meet this demand.

Senator **Rudman**. Well, other than transportation, which I can understand is your people's mercy on that, but why would———

Mr. **DiBona**. Transportation is a big chunk of it.

Senator **Rudman**. I understand, but why would it cost a refinery in Texas more to produce a barrel of oil if the temperature is 30 below zero or 30 above zero?

Mr. **DiBona**. It was not that the temperature was cooler. What it was was that the refinery has a slate of products. Fifty percent of the refinery is normally gasoline for the average refinery in the United States, 25 percent—really, about 21 or 22 percent is normally———

Senator **Rudman**. You are saying if they switch in the refinery, the product costs are higher?

Mr. **DiBona** [continuing]. So if you start to produce more heating oil, you run the refinery in different ways, in ways that are more expensive. You also produce less, for example, gasoline which is one of the products on which you make better profits.

Senator **Rudman**. For the record———

Mr. **DiBona**. So, in order to meet this demand, you incurred additional costs, so the fuel that was being produced in the month of December, the heating oil costs more than what occurred in previous months.

Senator **Rudman**. Mr. DiBona, I do not have any argument with that, because I am not an expert in that. Mr. Chairman, for the record, I think that answer ought to be backed up with something for the record, and I would appreciate it if you would supply for the record an amplification of that answer. I am not arguing that it is true, but I think for our record to be complete, that is a very important answer and one that we would like to have a copy of.

Mr. **DiBona**. We do not have individual cost data for refineries, so I cannot supply you with specific cost data, because we cannot collect that because we are a trade association, but that is the way in which———

Senator **Rudman**. Well, who can tell me that, Mr. DiBona?

Mr. **DiBona**. This gentleman could tell you that and others could tell you that.

Senator **Rudman**. Do you agree with that statement of Mr. DiBona? Is that an accurate statement, the statement of fundamental costs?

Mr. **Tilton**. That is fundamentally correct, yes.

Senator **Rudman**. Could you supply us with some idea of why that is so, because that comes as somewhat of a surprise to me?

Mr. **Tilton**. I think we would be glad to. We have a situation, of course, where I would rather not divulge proprietary information on individual costs for particular refineries———

Senator **Rudman**. I understand that.

Mr. **Tilton** [continuing]. Nonetheless, yes, we would be glad to amplify on it.

Senator **Rudman**. To the extent that you can, would you please do that?

Mr. **Tilton**. Yes, we would be glad to amplify on that.[1]

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[1] See p. 413.

Senator RUDMAN. Mr. Chairman, may I just ask one more question. Unfortunately, my time is up, and I am sorry about that.

Senator LIEBERMAN. Go ahead.

Senator RUDMAN. Mr. Tilton, in the Northeast in particular, where we are dealing with so much imported oil, did that have a major role to play in what happened to us up in New England, or would you say that the speculation on the various commodity markets might have had an equal role to play in the increase in costs?

Mr. TILTON. I would say, Senator Rudman, to the extent that the supplies that would normally come to the East Coast from Europe that are obviously factored in over time, on what the demand is going to be in the Northeast and how it is going to be supplied, it obviously works back and affects the inventory strategies of various suppliers from the United States into the Northeast. When those barrels did not move from the Rotterdam market to the East Coast of the United States, because they had more attractive economic disposition in Rotterdam, it had enormous effect on the situation.

Senator RUDMAN. Just for the record, Texas went through an enormous problem several years ago with a private antitrust action. As I understand it, the corporate entity that you head, Star or Texaco Marketing, and so forth, is owned both by Texaco and half owned by someone else.

Mr. TILTON. If I could help you with that, Senator, Texaco Refining & Marketing, Inc. is a shareholder and 50 percent owner of Star Enterprise, which is a joint venture company.

Senator RUDMAN. Who owns the other half?

Mr. TILTON. Saudi Refining, Inc.

Senator RUDMAN. So, the Saudi government owns the other half of your refining——

Mr. TILTON. Value Refining is a subsidiary or Aramco Service.

Senator RUDMAN. Thank you, Mr. Chairman.

Senator LIEBERMAN. Thank you, Senator.

I want to continue for a moment in pursuit of the elusive hundreds of millions of dollars here. We know that the consumers of America, business and residential, paid a great deal more for heating fuels in December—in Connecticut, $70 million more, so it has got to be over a billion nationally, I would guess. Let's say hundreds of millions. From what I see, the price of crude did not go up much. We have had various estimates suggesting in December it might have gone up about $1.20 a barrel.

Numbers that we have seen suggest that Exxon—we only have Exxon figures here—raised its price of refined product from $27 a barrel to $47 a barrel. I look at that $20 increase, and I compare it to $1.20 increase in the price of crude, and it looks to me like the oil companies made a lot of money, more money than they were making for November and earlier. But you are saying that your profit margin for December was the same, and so this is one of those cases where everybody is pointing at everybody else. We all know that we spent a lot more money for oil, so who got it?

Mr. TILTON. As I say, Mr. Chairman, I think it is awfully difficult to segment a group of particular winners in this situation. In our view, when you have the convergence of circumstances lead to a 54 percent increase in demand for us, as one company, and we scrambled to meet that demand, driven by the fact that we want nobody out of fuel, there are going to be people who are going to win, driven by our impulse to supply it, by our obligation to supply it.

When you sort it all out, after we are through accounting for extraordinary costs that were incurred in bringing product to consumers, the net profitability I suspect is going to be more elusive than even we suppose today.

Senator LIEBERMAN. So, who got the money?

Mr. TILTON. I appreciate——

Senator LIEBERMAN. First, let us get the figures correct. It is undeniable that we all paid more, so it went somewhere.

Mr. TILTON. Yes.

Senator LIEBERMAN. The price of crude didn't go up very much, did it?

Mr. TILTON. No, Senator, but I guess the one thing that I want to impress upon you is the cost certainly went up.

Senator LIEBERMAN. The cost of——

Mr. TILTON. Associated with bringing the product to market.

Senator LIEBERMAN. The cost of crude went up $3.65 between late November and late December. It is still substantially below what the resale price was.

Mr. DIBONA. Well, the heating oil only consists of about a quarter of the output of the refinery, so that while its price rose very, very sharply, it was not that you could convert a barrel of crude oil into a barrel of heating oil. You convert 22 gallons of crude oil into something like 10 gallons of heating oil and other things.

Some of those other things do not have price rises, so that the idea of taking margin by simply taking the price of crude and then the price of heating oil and assuming that that reflects the increase in monies received by a refiner does not take into account the fact that only a small fraction of the total barrel results in heating oil, and to the extent that you produce these other products, you affect the other markets, particularly if there is less demand for those other products.

Senator LIEBERMAN. I understand.

Mr. DIBONA. That has to be taken into account.

Secondly, the way in which they did it was more expensive and the way in which they transported the fuels were more expensive.

Senator LIEBERMAN. In other words——

Mr. DIBONA. So, you would take the more expensive crude, not as much more expensive than the heating oil——

Senator LIEBERMAN. Not as much as being charged, right.

Mr. DIBONA [continuing]. In converting it into 10 gallons of heating oil and 32 gallons of something else, which is not having the same price rise and in some cases softening the market, you are moving it by barge and truck, instead of by pipeline, and all of those things affect your profitability.

Senator LIEBERMAN. Mr. Wesson, you live in this business; you are familiar with it. Let me just ask you if you can shed some light on this. You say at one point in your statement, "There is no question that the refiners have substantially increased their margins during the month of December. I believe that these profits will be reflected in the fourth quarter financial statements," et cetera. Tell us what you meant there. Who did it? How did they do it?

Mr. WESSON. Well, all I know is that in the end of November I was paying 63 cents a gallon for heating oil and by the middle of December I was paying $1.22. It seems to me that anybody that manufactured heating oil, that owned inventories of heating oil or that speculated on heating oil in the mercantile exchange had to make a profit.

Senator LIEBERMAN. Right. Isn't some of this due to speculation on the mercantile exchange? I know we have heard references to the conditions that existed in the third week in December—the fire in Louisiana, the other factors—but those occurred after the cold had hit and there was already a shortage in the market. Isn't it true that speculation then occurred on the mercantile exchange, which drove up the cost of the product, and that higher cost was then reflected throughout the system? Can I ask you to give me a short answer to that question, either of you?

Mr. TILTON. Mr. Chairman, I think that the assumption of shortage of any commodity, in this instance home heating oil, will drive the market up, irrespective of the anticipation of specific speculators, whether they are taking physical possession of the barrels or not.

Senator LIEBERMAN. Is it because it is future action, and irrespective of the situation at that point, you had a lot of product coming in that you distilled earlier in the month?

Mr. TILTON. Simply put, Mr. Chairman, it is an assumption that you are going to be able to dispose of the product, either physically or otherwise, at a later date at a margin.

Senator LIEBERMAN. Okay. Senator Cohen.

Senator COHEN. Thank you, Mr. Chairman.

Mr. Tilton, what did you think of Mr. Wesson's notion about having a regional storage of petroleum available as a standby to hedge against these kinds of shortages in the future?

Mr. TILTON. I suppose, Senator Cohen, that I would caution against reaching that conclusion on the basis of what we have witnessed in December. Philosophically, I do not think I have any disagreement with the need to. Obviously, the market hedges its position and the consumer may well have an interest in hedging their position. I am sure that we all recognize that, for example, in Europe the consumer hedges their position with a 2,000 gallon tank in their backyard and they understand the workings of the futures market and they manipulate it, they work it to their benefit. I would say that inventory management for anybody's account, Senator Cohen, is a very difficult and costly activity.

Senator COHEN. Whether we have a Strategic Petroleum Reserve that would want to maintain for our national security interests, while this does not rise to the same level of importance, nonetheless, we have some kind of a reserve to take care of the kind of unexpected crisis that has emerged, that might be appropriate?

Mr. DIBONA. It depends on how frequently they occur. I mean if you try and prepare against an event that occurs in this case once in 72 years, it is a very expensive way to provide protection. You will be better off insuring that there is adequate funds and a low-income energy assistance program to deal with this and let the system respond by extraordinary measures to the extraordinary event. If you are trying to deal against variations that occur once in three or four years, then it makes sense to have the stocks, but that is really what those stocks do.

Mr. WESSON. Senator, if I may, the commodities exchange has unquestionably provided a disincentive for retailers to hold inventories. During December in the last three years, the price in the commodities exchange distillates has declined, and when retailers face that risk of decline, they tend to minimize their inventories. Facing that risk, how else are we to insure that there is adequate supplies of distillate?

Senator COHEN. Thank you.

Senator LIEBERMAN. That is very important.

Senator Glenn.

Chairman GLENN. The percent of the supply that comes in by spot buys, what would be the percent of the overall supply? Spot buys have been indicated as one of the culprits in this case where the cost of spot buys went up so much and this had to be reflected. What percent of our total supply comes from spot buys?

Mr. DIBONA. I do not know the answer.

Mr. TILTON. I cannot answer for the industry, I do not know the industry number, but I do know that, as we said earlier, it varies, it frankly varies with the attractiveness of the market on the East Coast relative to the attractiveness of the market in Rotterdam.

Chairman GLENN. Where does most of the Northeast oil come from? Is it foreign oil?

Mr. TILTON. I would imagine, Senator, if we trace it all the way back to the crude oil that is refined into home heating oil for the supply of home heating requirements in the Northeast, the proportion is probably equal to the 50 percent number that we use in aggregate for the country.

Mr. DIBONA. There are about 35,000 or 40,000 contracts that move a day on the exchange, on the spot exchange, and they are about 1,000 barrels, and so you are dealing with about 35 or 40 million barrels that move every day, so it is trading among people who are trying to hedge and do other things.

Chairman GLENN. What I was trying to get at was the effect of this, as price went up and down on the international market, obviously we cannot control all of that, but, on the other hand, all the major companies have a lot of their own fields, too, and they are producing out of that and the cost of producing out of those fields did not go up because the weather got cold. The refineries went down and you had some problems there. Did all companies go up about the same amount in their prices, Mr. Wesson?

Mr. WESSON. I would say that pretty equally, but our prices are dictated by the marketplace. Someone said there were about 17 buyers. There are 70 oil companies, heating oil dealers in Waterbury, and I set my prices based on what my competition is doing. All of them, I am sure, reflected the increase in their costs, but we are very sensitive to our customers.

Chairman GLENN. Would there not be a big variation in the cost increases in the costs to individual companies?

Mr. WESSON. Yes, there could well be——

Chairman GLENN. They would not be all the same. They are not always dependent on spot buys, they did not all have refineries go down, and yet apparently all their prices went up about the same. Does that figure?

Mr. **Wesson**. I cannot explain it.

Chairman **Glenn**. Mr. DiBona, do you think that is legitimate? Everybody did not have a refinery go down, everybody was not buying the same amount on spot buys, and yet the price of all companies seemed to have gone up about the same amount. That is hard to believe that was just coincidental.

Mr. **DiBona**. Well, as President of a trade association, I cannot collect price data, so the only data I know about is what is available publicly. There are a very large number of heating oil dealers and a very large number of refiners in this country. There are over 100 refining companies and there is something like 9,000 heating oil dealers, so there are an immense number of transactions going on at any one time.

Chairman **Glenn**. Well, our question, when you come to a crunch like this, we have unusual weather once in 100 years and the price starts going up, is whether all these 100 companies just happened to have exactly the same price increase and just happened to pass all this along and just happened to double their price to consumers, even though their barge and truck traffic, as mentioned, and their refineries going down and the spot market are a variable from one company to another. It is hard to believe that all of these things just went up accidentally.

Mr. **Tilton**. Senator, the value per barrel of home heating oil in New York Harbor is a rather transparent price, it is published every day in a variety of different publications. Any company, I think in the second two weeks of December, Senator Glenn, that attempted to undersell the market, would have found itself victim to the phenomena that Mr. Wesson was describing, where trucks were moving from one terminal to another seeking the best price for the purpose of reselling at some semblance of a margin, then you would have been, frankly, without product in a very short while. The marketplace, principally driven by the New York Harbor spot location on the value per barrel of heating oil, set the price.

Chairman **Glenn**. A good chunk of your supply comes from the Saudis as a partner in your company, right?

Mr. **Tilton**. That's correct, yes, sir.

Chairman **Glenn**. How much do they dictate the price when they see a shortage coming up and how much control do you have over it? Do they set it without any consultation with you and you just have to accept that?

Mr. **Tilton**. They do not, no, sir. It is different, perhaps, from the disposition of crude in the industry as a whole. In the negotiation of the joint venture agreement, that price is a formula price, is subject to the move into the market basket of crude, domestic crude, I might add, in the spot market.

Chairman **Glenn**. Just one further question. When we are talking about spot buys, it has been brought up repeatedly as a major factor here on this, as though that was a major part of the supply, I guess in normal times and in times like this, at crisis times, too, as far as weather is concerned. Is that mainly, what, Iraqi oil, Iranian oil, Indonesian? Who supplies what percent of the spot buy oil?

Mr. TILTON. Senator, this is principally finished product, so we were not talking about crude oil. We were acquiring——

Chairman GLENN. Who supplies the spot buy of finished product, then?

Mr. TILTON. I would say that it moved from the European trading community, it comes from Venezuela, it comes from Canada, sir, it comes from the Virgin Islands. To make it economically attractive on the East Coast of the United States, it needs to be in reasonable geographic proximity, otherwise it cannot stand the freight penalty.

Chairman GLENN. My time is up. Thank you.

Senator LIEBERMAN. Thank you, Senator.

Two final brief questions. Mr. Tilton, are you personally aware of any conversations that occurred during the month of December among major oil companies about home heating and propane pricing?

Mr. TILTON. Absolutely not.

Senator LIEBERMAN. And you were not personally involved in any such conversations with anybody from any other——

Mr. TILTON. Certainly not.

Senator LIEBERMAN. Thank you.

Mr. Wesson, from all that I have read and learned about what happened in December, the testimony that you offered that the distributor, the person that delivers the oil to our homes and businesses, did not make additional money is accurate, to the best of my understanding of the situation.

Now we have a circumstance where testimony indicates and our own understanding shows that the wholesale price of fuel is dropping. What assurance do consumers have that the average retailer will be able to resist the normal inclination not to drop that price as quickly as it rose to its current level?

Mr. WESSON. Senator, I think the protection that the consumer has, as I mentioned before, is that in Waterbury there are over 70 heating oil dealers. Their prices of heating oil are published in the Waterbury newspaper every day. Everybody is very responsive and, as one retailer drops his price, every other will also do it to be competitive.

Senator LIEBERMAN. Has that begun to happen?

Mr. WESSON. I think it certainly has, the retailer price has already dropped over 10 cents a gallon, and yet the wholesale costs are still high. Most heating oil retailers are selling products that they acquired in the last two weeks at the highest possible prices.

Senator LIEBERMAN. Okay. We have got to move on to the next panel. I thank you very much for being here.

We will now call the next panel. We have three more panels. They are good panels, and I hope people will stick with us and continue to learn more about what happened during December.

This panel consists of three people who have spent most of their professional lives in the energy area, and we thank you for being here. You have different perspectives, clearly, and I would like to ask you to help us to understand what happened and, I suppose more to the point, what can we do to prevent it from happening again.

Mr. Verleger, you are first on the list.

TESTIMONY OF PHILIP K. VERLEGER, JR., VISITING FELLOW, INSTITUTE FOR INTERNATIONAL ECONOMICS, WASHINGTON, DC [1]

Mr. **Verleger**. Thank you, Senator.

Let me summarize my testimony, as follows:

First, the increase in price that was observed was the result of structural change. No country, no organization, no company dictates the price of oil today. That goes for crude oil, as well as products. Now, the price of heating oil are set most entirely on the New York Mercantile Exchange in the United States.

Second, the increase in prices was caused by cold weather. One can model—and I have been modeling in connection with antitrust and commodity market manipulation lawsuits—a relationship between heating oil prices and cold weather. A key variable is abnormal degree days. This instant episode we had was the coldest period of weather in the decade of the eighties. I have heard it referred to as the coldest in 70 years. But if you look at episodes in terms of their length and the elongation of the abnormal temperature, this was marginally colder than one other episode.

Given the cold weather, one can predict that the demand would have increased by roughly 560,000 barrels a day, that is heating sensitive demand by homeowners and commercial users. That should have pushed the spot price of heating oil up to roughly 80 cents a gallon, 75 to 80 cents a gallon. This demand, however, was augmented by two other factors.

First was the freeze in the Gulf Coast refineries, which occurred over the Christmas weekend. That took an additional 200,000 to 300,000 barrels a day out of the market for two weeks, with an intense period right after Christmas. As we have heard, Texaco had troubles, Exxon had trouble, Shell had three or four refineries close. Companies that were forced to close their refineries because these units do not operate well in cold weather and because their natural gas supplies were cut off, that is, the pipelines refused to give gas to the refineries so the refineries had to shut down and stop manufacturing heating oil, per the FERC regulations, added further to the price increase.

In addition, there was further increase in demand caused by the shifting of utilities in the New York Harbor area and in the Northeast from gas to heating oil. Mr. Lichtblau last week suggested that was about 125,000 to 150,000 barrels per day of demand. That also added to the price and I can get it to 95 cents, give or take a little.

As part of that, this utility demand, the utilities also tied up the logistical system by essentially hiring all the large barges. There was a serious barge problem in New York Harbor. I am aware of one foreign cargo of heating oil that was going to come into New York Harbor, could not because it could not reach the docks, attempted to use a different system to liter the fuel, stopping at the first terminal, going on and then coming back and was denied per-mission by MIRAD. That was not covered this morning, either. The logistical problems in the harbor and this sudden demand for the utilities added to the prices.

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[1] See p. 243 for Mr. Verleger's prepared statement.

The futures market was not, in my view, the cause of the problem. It does increase the volatility, but one does not find much of a difference in terms of the prices. The futures markets provide a mechanism by which commercial firms can ensure themselves against loss. We heard a minute ago from the heating oil dealer in Waterbury about the risk of loss on inventories. Futures markets traditionally provide a mechanism of this sort, and I believe the stocks would be lower today if there were no futures markets. What happens is commercial firms build inventories and sell futures against their position.

Statistics from the Commodity Futures Trading Commission, the CFTC, a Federal agency, show that as of November 30th, 70 percent of the open interest in the heating oil contracts on the short side, that is sales, were by commercial firms, which the CFTC defines as firms that regularly use futures to hedge. The CFTC data show that 50 percent of the open interest on the long side was by commercial, so that the commercials were short a net 20 percent. Now, the CFTC data are published only once a month. If the commercials were to have held their position, though, on the futures markets, they would have lost something on the order of $500 million during the episode.

That leads me to my fifth point, that it is really difficult to look and identify who made the money and who lost the money. A corporation like Texaco might have lost money by buying in the spot market, but if they are being prudent, they hedged on the opposite side.

I would also note, as a final point, that these markets could be used by consumers or by heating oil dealers to tie down the price for consumers. The consumer can lock in—I do not want to use the word "fix," although that is the traditional commodity word—the price of heating oil in July for the whole season. Consumers could have bought heating oil or dealers could have bought heating oil for January delivery at 50 cents a gallon this last July. Unfortunately, consumers have seen prices go down every year, they have benefited from the commodity markets. As a matter of fact, the U.S. consumers have received a far greater benefit from the commoditization of oil than any other consumers, so they tended not to take advantage of these instruments. They paid, unfortunately, this time.

Thank you.

Senator LIEBERMAN. Thank you.

Mr. Poats.

TESTIMONY OF RUTHERFORD S. POATS, DIRECTOR OF RESEARCH, ENERGY FUTURES GROUP, INC., BETHESDA, MD [1]

Mr. POATS. Thank you for the opportunity to testify, Mr. Chairman.

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[1] See p. 262 for Mr. Poats' prepared statement.

My written comments are a rather detailed assessment of the short-term market factors contributing to the recent heating oil price increase, therefore, I would like to focus my oral comments on three other areas, if I could.

First, I want to look at a broader perspective of some of the contributing factors to the recent price surge; second, some observations on the role of futures markets and the price formation process, as well as their incremental impact on the inventory management; and, third, some immediate specific solutions in the form of consumer protection initiated at the end-user or consumer grass roots level, perhaps with the assistance of State and local governments.

First, from a broader perspective, it is important to view last December's price rise in the context of the petroleum industry's structural and competitive evolution over the last decade. In particular, I would note the U.S. industry's increasing reliance on not only imported crude oil, but also petroleum products and, hence, on foreign refining and distribution capacity.

Second, globalized competition restructuring have increased both U.S. and worldwide reliance on relatively transparent and sensitive forward spot futures markets as a pricing standard. This reliance extends to the final consumer. As a result, industry events affect both crude oil and petroleum product availability are translated more rapidly through the pricing chain, but also induce a more rapid corrective response than was the case 5 or 10 years ago.

As producers are certainly aware, these markets can drop precipitously as well. Now, however, we find ourselves in a period of industry cycle characterized by capacity constraints on the production of light refined products. Barring a reversal in demand trends over the next 3 to 5 years, substantial investments in new refinery capacity will be needed both domestically and internationally, if refinery capacity is to keep pace with both demand growth and stricter product quality requirements.

It is my opinion that the probability of these product-led price spikes as occurred in 1989 is likely to increase in the foreseeable future, simply because current refinery capacity levels are insufficient to accommodate unexpected surges in demand or breakdowns in the supply system.

In a nutshell, our capacity safety margin has been eroded, if you will, to absorb these kinds of events. This condition of exposure is likely to prevail until we find the industry catches up in its downstream processing capacity

To some extent, this December shortfall in distillate fuels can be viewed as the split side of last spring's gasoline price spike, which was fueled, of course, by the Valdez incident and refinery problems on the West Coast and on the East Coast by stricter RVP standards, quality standards. The immediate effort to maximize gasoline output resulted in excess distillate output and even resulted in negative incremental refinery margins on distillates for a period of time last spring Pressure on gasoline markets persisted through the summer as a result of normal refinery maintenance turnaround schedules of September were delayed until October and November, limiting the normal pre-season stock building of distillates, as was discussed. However, this showed that the current emphasis to catch up on distillate supplies could create the potential for a tight gasoline market again this spring.

Tighter inventory management policies also should be viewed in the context of the industry's increasing competitive pressure to function at very narrow margins. Independent refiners and distributors must compete with larger refiners, both domestic and offshore, that enjoy relatively good access to crude at competitive prices. Operating costs, which are inventory carrying costs, for a large part must be kept at low levels in order to compete around narrow price margin differentials. The pressure to minimize inventory carrying costs is particularly greater around major consuming areas.

I believe that the evidence demonstrates that downstream storage capacity has not only declined over the last 5 years, but its level of utilization has also declined. The same condition applies to marketers or secondary storage and end-users of tertiary storage.

In some respects, our exposure to temporary supply demand balances reflects our over-reliance on a flexible supply system which guarantees that normal problems of deliverability will be temporary ones. Indeed, the price translation of this tight inventory phenomenon can be seen in the industry's futures market time-spread balance, specifically the differential between the nearby and the second month or farther forward month prices.

For most of the past 5 years, prompt crude oil has traded at a premium to the forward months, the refined product market seasonal factors influence the time-spread price relationships, but when disturbances do occur, their impact are far more pronounced on the nearby or prompt cash market price than on the forward or expected price. This is evidence of the overall expectation of long-term supply adequacy, despite short-term strength to meet demand, a natural result of competition.

The role of futures markets on inventory behavior should also be noted in this context. The ability to substitute a paper or a long-hedge position for physical inventory position is certainly one way to reduce incremental carrying costs. Many buyers of refined product in the downstream end of the distribution chain take advantage of this capability, naturally. However, for every future buyer there must be a seller and, as Phil addressed, in the final analysis, the commercial seller is a hedger with access to supply at reasonable costs relative to hedged price.

However, to impart speculative participation, perhaps some recent over-reliance on supply availability prior to its appearance in downstream storage tanks. However, I should note that consumers or end-users are also somewhat responsible for not following more prudent inventory management policies.

Most available incremental storage capacity is held at these downstream levels.

Senator LIEBERMAN. Please try to summarize, if you can.

Mr. POATS. I will finish rapidly.

By instructing the suppliers to hedge their price for them, either directly in the futures market or perhaps physical inventory, they could have preventing this kind of action. The critical point is who is going to pay the insurance premium.

I have several recommendations within the financial and the physical side for how end-users, perhaps with cooperatives and State and local organizations' help, could pursue more vigorously a price insurance activity in the existing free market structure.

Senator **Lieberman**. We have those in your statement, and I would like to ask you about them in the question and answer period.

Mr. **Poats**. All right. Thank you.

Senator **Lieberman**. Mr. Rothschild, are the oil companies right? Did they not profit unduly during December?

TESTIMONY OF EDWIN S. ROTHSCHILD, ENERGY AND ENVIRONMENTAL POLICY DIRECTOR, CONSUMER ACTION, WASHINGTON, DC [1]

Mr. **Rothschild**. I do not think you will ever get oil companies to admit that they profited unduly ever.

Senator **Lieberman**. You are probably right.

Mr. **Rothschild**. I have followed the hearings for many, many years and it never happens, there is always something else to lay the blame on, whether it is the weather, cost factors, transportation, they will come down the list, you go to the hearings and it is the same story.

For the Committee's benefit, I have got a little bit of an estimate here on the windfall profits of heating oil. Table 1 of my testimony that I just delivered is an exercise, albeit rough, it just looks at December, it looks at just the stock drawdown, in other words, at the value of the stock, what it was, and at the selling price and calculates that windfall.

The second one is on production, assuming the normal refiner margin, which is about 18 cents or so a gallon. That assumes the excess margin above that times the actual production of domestic during the month. We do not calculate imports, because we assume there was an even trade, you buy at 95 cents, like Texaco was saying, on a spot market of imported product, you are not going to make any money. You may lose money, and this does not reflect that, but at least it is a ball park direction. I think the industry should come up with some kind of response. In any case, we are talking about $852 million in December alone, an estimated of windfall profits that somebody made.

Senator **Lieberman**. Estimated windfall profits for the industry?

Mr. **Rothschild**. Yes, on stock drawdown, on domestic production. Now, on the domestic production issue, how can it cost that much more in refining, if crude oil prices go up minimally, and they did not go up $3.50. That was WTI's spot prices that went up, and oil companies in the United States do not by WTI spot. If you look at the refinery acquisition cost on a regular basis, it is much lower than spot, it is about $1.50, I think is the normal price that the companies are going to be paying for higher crude costs.

If they are running the refinery at higher operating efficiency, that means their cost must be going down. If they are not using their gasoline components, that means their costs are going down, because those are very expensive to use, as they probably testified during the gasoline period, when we have to make more gasoline, it costs us more to make because those are more expensive to run.

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[1] See p. 306 for Mr. Rothschild's prepared statement.

Well, something has got to—they have got to show where that money went and what the costs were. I think the costs were no more in terms of refining. If anything, they were probably less.

Transportation? Well, most transportation is already booked, it is on pipelines. It is only that marginal transportation on barges that may have gone up and that only affects a small amount of the market, so if there are any cost increases, it seems to me, Mr. Chairman, they were minimum.

Going beyond that, in terms of profitability, I think you also ought to look at cash flow for the industry, which——

Senator LIEBERMAN. Let me interrupt you for a clarification. I want you to respond to the argument of the gentleman from Texaco that in fact Texaco did not profit because it was forced to go into the spot market to buy product to meet its customers' needs, and that offset any profit they might have made.

Mr. ROTHSCHILD. Well, I remain to be convinced what the difference is between what they purchased and their inventory drawdown and the money they made on that for what they bought and whether they made or lost or broke even on, so I think we have to look at that company by company, is something that certainly the EIA may be able to help with. And you do not have to have it broken down company by company, they can give you the impact on the top four or top eight companies and can still give you very good information, without divulging the names of the companies. It all depends on how you ask for it. They can give you market share data.

Mr. DiBona talked about market share on a national basis. Market share on a national basis is irrelevant. His data is meaningless. What you want is market share in regions or in cities, in point of market share, the wholesale sales in certain regions.

The other thing that is important is where does this refined product come from that everybody is buying. Well, it comes from other refiners. The majors have refineries overseas. The refinery in the Virgin Islands isn't some weird refinery, it is Amarata Hess. The refineries in Venezuela are Venezuelan state-owned companies, and Venezuela also is joint venture now of fully owned operations here in the United States.

Texas is joint venture with the Saudis. Well, while the product products go up—by the way, other product prices went up, too, contrary to Mr. DiBona. Gasoline prices have gone up, jet fuel prices have gone up, propane prices—some propane is also produced in refineries, along with natural gas streams—have gone up, so, if anything, their product slate, if you want to make a true margin between their overall product slate and the cost of crude, it is has probably been much greater than it has been in many, many months or years.

The point is that that refined product comes from other refineries, so certain refineries, whether they be domestic or overseas, are certainly cashing in, as the wholesale price of the product rises, and that is where to look for where the increase comes from. Clearly, the dealers, we have done dealer margins, have not gone up that much, and you know, we are concerned that does not happen, as you were concerned about, over the coming months, but so far that has not.

Senator LIEBERMAN. Just to reassure you, we have requested the kind of information you have just described from the Energy Department.

Mr. ROTHSCHILD. The other thing I want to go forward on is to bring to your attention Table 3. We only have data up through October 1st inventories that come from the EIA and their monthly petroleum supply monthly, and it follows where the East Coast supply comes from and most of it comes from shipments from the Gulf Coast of the Unites States. And if you look at the two months that we have, which is before the heating season, August and September, there are close to 5 million barrels below what they were the previous year. Similarly, imports were down a little over 3 million barrels.

If you want to look where the reason was for the decline in inventories on the East Coast, you can look at those two factors. The production from the East Coast refinery was up in both months, and product supply, demand during those two months were about even, and so the reason that stocks declined prior to the winter heating season had to do with the Gulf Coast refineries before anything happened to Exxon, Exxon, Texaco, Chevron, all these big refineries.

One of the things you want to consider—and I think Mr. Poats raised this—is this industry has changed and one of the things that may be happening is they may be emphasizing more and more the production of gasoline, because they make more money over the entire year on gasoline than they do on heating oil, so they may have much greater reason to not make heating oil, particularly if they know that if it is a terribly cold winter, the prices will skyrocket and they stand to gain a great deal.

I will stop there, Mr. Chairman, and will be happy to answer any questions.

Senator LIEBERMAN. I appreciate your testimony. Thank you.

Let me start with you. Do you think that the futures market contributes to lower or higher prices?

Mr. ROTHSCHILD. It depends on the weather. Well, it certainly does, because the futures market can go either way, it is a very volatile system. But when there are fears about supply, it really will help magnify it, and if people are going into the futures market in a desperate effort to buy up supply, they can also drive it up, and I think you have this kind of magnified panic that occurred. Had we had the inventory, it would not have gone up as much, because people would have had greater cushion to know which direction prices might have gone.

Senator LIEBERMAN. Let me ask you this: If you had it within your capacity, would you prohibit trading in oil futures on the mercantile exchange?

Mr. ROTHSCHILD. Probably not.

Senator LIEBERMAN. Because on balance, you would say that it is a plus, even though it can magnify a price rise on occasion?

Mr. ROTHSCHILD. I am more concerned about the underlying structural problems in the industry, the fact that we have limited refining capacity now, the fact that the industry is operating on a very tight level, so that when you have an *Exxon Valdez,* for example, companies are in a position to take advantage of the situation and drive up the price of gasoline to consumers. That is what concerns me. I do not think the futures market is where the problem is.

Senator LIEBERMAN. Let me skip back to something else, just to clarify what you are saying. In response to this question that we have been asking, which is where did all the money go, you would say that most of it went to the major oil companies?

Mr. ROTHSCHILD. I would say that, looking at this data, it went to the major oil companies. Certainly, there are probably people in the marketplace, brokers, people who trade, traders who probably made a greater bundle, too, but I think in those two areas where we are talking about, nothing beyond that.

Senator LIEBERMAN. Okay.

Did you want to say something, Mr. Verleger?

Mr. VERLEGER. Yes, I did, sir. There have been several statements made about the futures market today and the New York market is not a client of mine and I have never consulted to them. I have approached no favor and I think it will create a serious problem, in the next real energy crisis, in the commodity market. The import of my work study at the Institute for International Economics says that the structural change of the market that I described and that Mr. Poats described will substantially exacerbate the price increase.

Senator LIEBERMAN. Is there something we should do to protect ourselves from that?

Mr. VERLEGER. Yes, I think there is. But in terms of what happened this December, focusing on that, the trading in the December contract was mostly by commercials. The cost of trading in——

Senator LIEBERMAN. In other words, not by speculators?

Mr. VERLEGER. Not by speculators.

Senator LIEBERMAN. By people actually in the business?

Mr. VERLEGER. Yes. The cost of trading in that contract or holding a position overnight goes up dramatically when it becomes the expiring contract, that is, on December 1st. And on the last two days, I believe the MERC required that a firm taking a position on it posts a $20,000 deposit for every contract that they held. Now, the total cost of a barrel of oil would be about 1,000 barrels of oil, which is represented by the contract, is only $40,000, so that is a very high margin, that is even a higher margin than the Brady Commission proposed after the events of October 1987.

If one looks at the rate of liquidation in the January contract during December—and I figured four in my prepared testimony—the rate of liquidation was identical to the rate of liquidation we saw in 1988, that is, the number of contracts outstanding on a given day in December and the percent of the number of contracts outstanding at the beginning of December is about the same, I mean it just declined nicely.

The futures contract in the futures market is the window we really have which provides a transparent window into the market now, gives us better information on our prices and the buying and selling reflects conditions of supply and demand. Now, what happened was we had a very strong demand, perhaps 33 percent above normal and more, given the fact that we lost supply, then the price increase would be expected.

The other point that ought to be made is that over the year as a whole, the margin that was made in all of 1989, the margin made on heating oil in New York, and this is spot price versus the spot price of crude, was $3.26 versus $3.29 the year before. That is because companies were having to give away heating oil or to sell heating oil below cost in June, July and August, and there is something I think incumbent, not just on the large oil companies. When we look at the large oil companies, I think they do not sell much oil in Connecticut. You have some large companies in Connecticut that try to sell oil and they try to get buyers to sign up for some fixed-price contracts and the buyers would not sign up. It is something incumbent on the entire distribution system to build stocks and the fact that we cannot do this, because all the consumers look in the paper in Waterbury and see that the price is down today and looking for the lowest cost supplier exposes them to this risk.

Senator **Lieberman**. What about the energy crisis that you are worried about? What do you mean when you——

Mr. **Verleger**. Well, the problem one faces with commodity markets is that they move rapidly. The Department of Energy's distribution system for the Strategic Petroleum Reserve requires roughly 20 days to complete an auction. In that process, after, say, the loss of 3 or 4 million barrels a day from Saudi Arabia, all of these commodities markets will literally explode. The cost of oil arriving at any refinery in the Gulf Coast is today tied to the spot price of Alaskan crude oil and that price will rise dramatically over 20 days. It can go from $20 easily to $100.

We saw in 1976, in the coffee market, how these things can happen. All your economic models say maybe the price should double. Well, the price went up six-fold. The commodity markets are extremely delicate and when confronted with losses in supply with low inventories or with sudden shocks to demand, you get very explosive movements of prices, and I have been writing—I have testified before Congressman Sharp's committee on the need to revise our distribution system for the Strategic Petroleum Reserve and also the need probably to build a much larger reserve to allay the fear of these very large spikes such as we saw here and such as we saw in April in California.

Senator **Lieberman**. So, you would say the one specific step that Congress should take is to provide for a Strategic Petroleum Reserve that could be moved into the market in times such as we had in December.

Mr. **Verleger**. In a timely fashion, absolutely. Congress has always taken the lead, since passage of the Energy Conservation Production Act in 1976.

Senator **Lieberman**. Okay.

Mr. Poats, why don't you just take a moment and describe the basic approach that you are suggesting to grass roots consumer groups as a way to get into the market and avoid some of the pain that we all suffered in December.

Mr. **Poats**. Certainly, I would be glad to. Phil alluded to this.

The problems are, in part, the fact that the end-users, consumers if you will, State and local governments are the buyers of oil products, perhaps have not and perhaps need to think about in the future essentially paying an insurance premium or limiting their down-side potential to participate in price drops through either financial or actual physical contractual relationship, going to fuel suppliers or going to financial intermediaries and possibly even directly to the exchanges and locking in their costs perhaps for several months of the year that they view to be particularly exposed, particularly wintertime.

Now, there are several ways you might go about that, of course, going directly to your supplier and saying I want a fixed price for this year, please quote that in terms of a margin over your current costs of oil. As Phil said, if they had done that last August or so, they could have got 55 cents plus some margin, and that is one way to go about it.

The other way to go about it is to set up some group which has financial solvency and directly participate in the markets. A third approach would be to use what they call over-the-counter markets, essentially are primarily commercial banks and trading houses largely on Wall Street, that will offer a fixed price without requiring direct participation. The futures market essentially is referred to a swap, it has been enabled by some recent rulings that have made it easier to engage in these activities. But the point is that through an organization—I realize that the individual homeowners may be intimidated to some extent, but here the consumption is too small—through cooperative organizations, grouping perhaps State and local government and education, they could take advantage of some of these tools and actually participate in this risky market and reduce the risk.

The other set of approaches would be more physical, and I think my comments in my presentation alluded to the fact that perhaps, incrementally, the futures markets have increased over-reliance and reduced the amount of inventory that end-users and distributors might take downstream.

To the extent you have end-users essentially willing to pay a premium, whether it is for a hedge in a financial sense or literally to sock away inventory in advance of the heating season and pay a carrying cost or at least some portion of a carrying cost, you have increased the incentive to get oil into that market, particularly in the secondary and tertiary or end-user storage capacities available and avoid some of the panic buying and some of the stockouts, if you will, to push the commodity market up.

Senator LIEBERMAN. What do you think of that, Mr. Rothschild?

Mr. ROTHSCHILD. Well, it certainly sounds intriguing. We have State organizations in Connecticut, consumer co-ops, and certainly the advantage there initially is for consumers to take advantage of large buying power to reduce the costs, so you can save 10, 15 or 20 cents a gallon. It seems to me that if you already have an existing organization, that is the way maybe to take advantage of the future market.

As an individual homeowner, it is more difficult. You then have to negotiate with the dealer, you may get tied into one dealer, you know, you have to take those risks and you also have to be educated as a consumer, and a lot of people who buy heating oil really do not spend the time, do not have the background and capability to do that, and the question is how then to help them. Is that through the government? How about low-income people, should the government get into the position of buying oil on this basis for low-income communities? Maybe so, maybe that is a way to buy some protection. Certainly, for this winter it seems to us that we cannot do that and that is why we are urging Congress to really up the level of LIHEAP expenditures. People who are at low income level certainly cannot deal with the current crisis in any way whatsoever, and in many States the funds have already run out.

Senator LIEBERMAN. In addition to the increase in funding for low-income home energy assistance programs, what else would you recommend that we to do to avoid this problem in the future?

Mr. ROTHSCHILD. Well, I think, as mentioned, the Strategic Petroleum Reserve is a better way than our present situation, to store oil and use it as an insurance policy. Utilities do that. They are required, in order to serve in a State, to have excess capacity to meet the highest peak day demand, and people end up paying for that because that is an insurance policy and we recognize that there is a cost associated with holding reserves. Similarly, a State may require anybody who sells oil in the State to keep a certain amount of reserve by the first day of the winter heating season on hand, and again, there would have to be a way for the distributor or the marketer to collect the money for the storage, since they are adding that to their risks, so there are going to be costs involved but there are ways to reduce the kind of price spikes that we have seen through these methods.

Senator LIEBERMAN. Okay. I thank the three of you very much for your testimony. It has been very helpful and the committee will certainly consider it.

We are going now to the Attorneys General. May I exercise the prerogative of the Chair, since I have been sitting here for three and half hours, to take a 3-minute seventh-inning stretch. We will be right back.

[Short recess.]

Senator LIEBERMAN. The hearing will reconvene.

It is my esteemed personal pleasure to welcome Attorneys General Riddle, Tierney and O'Neil, former colleagues in two cases, and a previous deputy of mine, now improving dramatically on the record of her predecessor. Without embellishing too much, and acknowledging the fact that I consider myself a friend of the three of you, I think you represent the best in American public service and I appreciate your presence here and your patience.

Now, my normal instinct, based on comparative intelligence and attractiveness, is to call on Attorney General Riddle first. I understand that you may have a plane to catch.

TESTIMONY OF CLARINE NARDI RIDDLE, ATTORNEY GENERAL, STATE OF CONNECTICUT [1]

Ms. RIDDLE. Mr. Chairman and distinguished members of the Senate Government Affairs Committee, my name is Clarine Nardi Riddle and I am the Attorney General of the State of Connecticut.

I am deeply appreciative of the opportunity to express to this committee my views on the home heating oil crisis in this Nation. I am particularly honored to be able to address these concerns to my predecessor and friend, the former Attorney General of the State of Connecticut, Senator Joseph I. Lieberman, who proved himself over and over again to the people of Connecticut as a great advocate for consumers, the poor and the elderly.

Senator LIEBERMAN. Here, here. Thank you.

Ms. RIDDLE. You are welcome, most deserved.

To keep within the time frame, I am going to skip over some of the data that you have already addressed about Connecticut, but I would like to emphasize that the citizens of Connecticut are outraged, as they should be. The State of Connecticut has pledged to find the causes of this crisis, to report the results to our citizens and to prosecute any illegality or wrongdoing that we find.

We are well into our investigation of the crisis. Governor William O'Neill established a strike force, including our Energy Under Secretary, our Consumer Protection Commissioner and me. We have already obtained responses to a questionnaire submitted to 28 companies doing business in Connecticut that included every significant refiner, supplier and wholesaler.

We are currently analyzing the responses to those questionnaires. But what we have found, what we have already found is that some participants at each level of the industry—refiners, wholesalers and retailers—have increased their profit margins during the crisis. They have all gotten a piece of the action.

Because we already anticipate that we will need to ask further questions and because, quite frankly, some of the responses from the companies are less illuminating than we had hoped, we expect our next series of questions to include formal subpoenas that target all portions of the heating oil market—the refiners, wholesalers and retailers. As you know, we did not really target retailers the first round.

Our inquiry will not just target what happened during December. We will be watching closely to see if prices drop as quickly in response to market conditions as they rose.

Because there are some problems with the propane market, which supplies heat to some 13,000 homes in Connecticut, including instances of commercial customers actually running out of fuel, we will also be asking questions of the companies that supply propane to Connecticut.

We are proceeding basically along three parallel tracks. First, we are looking for indications of classic antitrust conspiracy related to horizontal manipulation of either price or supply. Second, we are examining the applicability of a Connecticut statute that may be unique in the country, enacted in 1974, is one that prohibits the illegal creation of a fuel shortage.

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[1] See p. 318 for Ms. Riddle's prepared statement.

Unlike antitrust theory, this statute makes unlawful unilateral contrivances of the fuel oil supply that are aimed at raising prices to consumers. This statute carries with it severe criminal penalties and civil liability, 5 years in jail, $250,000 fines and treble damage recoveries for consumers. And third, we are going to be looking at price gouging. I would like to send the message loud and clear to Senator Rudman that we are going to be looking at price gouging under our Little Federal Trade Commission Act. I would gratuitously add that I would hope that the Federal Trade Commission would also consider looking at price gouging.

We believe that merchants may not exploit market conditions in an essential commodity by increasing profit margins to unconscionably high levels.

As we all know, the problem is not Connecticut's alone. Our State's resources are limited, as those of most States. Despite our knowledge, experience and ability to coordinate with other States through the Eastern States Antitrust Committee and the National Association of Attorneys General, Multi-State Antitrust Task Force, quite frankly, we are just beginning that coordination by the establishment of an Ad Hoc Committee on Home Heating Oil Crisis, composed of Pennsylvania, North Carolina and Connecticut, and we have accepted a leadership role on behalf of other States. I, nonetheless, encourage the widest ranging inquiry by both the Legislative and the Executive Branches of the Federal Government.

It is State Attorneys General who return monies to consumers in both antitrust and consumer protection cases. If we find evidence of price gouging or the illegal creation of a fuel shortage, you can be assured that we will sue to return to Connecticut consumers what is rightfully theirs.

Historically, however, States have relied to a great degree upon the Executive Branch of the Federal Government to investigate national and international antitrust conspiracies and to provide the facts necessary for the States to institute civil suits to recover damages for themselves, their municipalities and their consumers.

Regrettably, based on the *Exxon Valdez* incident and what I perceived as a lack of vigorous action by the Justice Department and the Federal Trade Commission during that crisis, I am hesitant to wait for the Executive Branch of the Federal Government to get to the bottom of the crisis. Therefore, until we receive clear, unequivocal signals of a vigorous Executive Branch investigation, we must continue with our work.

The ultimate iron, of course, is that if, perchance, a horizontal price fix is found at anything other than the retail level, most consumers in this Nation will get absolutely nothing. The 1977 United States Supreme Court decision known as *Illinois Brick* v. *Illinois* states that only direct purchasers from price fixers may sue to collect damages.

The current heating oil crisis points out the folly of *Illinois Brick*. Heaven help us if a price fix is found by the Justice Department, the FTC or any State attorney general at the wholesale or refiner level of the industry. Consumers in this country will rebel. It is time for Congress to pass legislation repealing *Illinois Brick*.

I have attached a number of documents to the testimony. I hope this is helpful to the committee. We will keep the committee posted as the results of our work continue.

I would like to offer a comment that has not been offered by any of the prior panelists, is a possible look at the Canadian regulation in this area and the whole question of accounting, first-in/first-out, last-in/first-out, which I think has played a factor also in what we have seen go on in the markets.

Thank you so much for permitting me to address this Committee and I would be pleased to answer any questions.

Thank you.

Senator LIEBERMAN. Thank you very much.

General Tierney.

TESTIMONY OF JAMES E. TIERNEY, ATTORNEY GENERAL OF THE STATE OF MAINE [1]

Mr. TIERNEY. Senator Lieberman, thank you and members of this Committee for this opportunity to be with you again.

I am going to urge that the Federal government do three things as a result of the crisis which has hit my State and many States. The first thing we have to do, while the investigation is going on, is to provide some assistance for those low-income individuals who have had to pay these bills. We can debate, we can discuss, we can analyze for years, but there are people in my State who literally shudder in the dark. They need help and they need it now.

Federal funds in this area have been reduced by 30 percent in my State. Even the oil industry today has joined us in our testimony to ask for more immediate assistance to these individuals now before this winter is out.

The second thing which I think should be done is to investigate the opportunity to provide stability to the situation. The concept of the Strategic Oil Reserve to me is the most plausible way of doing this. Again, as you investigate the question of futures trading, I would say the issue is price but it is also predictability, which is an essential part of this issue as you investigate it.

I would like to spend most of my time this afternoon in talking about what I know best, which is enforcing the laws, the antitrust laws of my State and how I feel they should be enforced in this country.

You know, after the *Exxon Valdez* spill, gasoline prices all across America immediately went up because one ship had an accident. Attorneys General from the western part of the United States conducted an investigation and determined, as a result of analyzing this, that all of the Attorneys General should ask the Federal Trade Commission and the Justice Department to look into this problem, to see whether there have been violations of our antitrust laws.

To be blunt, our entreaties were ignored and the summer went away and people forgot that they paid the high gasoline prices and business went on as usual and the profits were deposited in the bank accounts of the oil industry. That was wrong.

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[1] See p. 331 for Mr. Tierney's prepared statement.

Now, here we are back again, only this time it is winter and this time it is cold. I appreciate the difficulty of this committee in trying to get answers out of representatives of the industry. We saw the best of them today willing to come and sit before this committee and try to share information, and yet, even then the answers were not forthcoming to your questions, Senator, and the questions of the others.

Well, I can assure you from my experience in Maine, that when we have an antitrust investigation and we ask people to come in, we do not get the kind of evasive answers that this committee is getting and that the public of this country is getting. There is nothing like an Attorney General investigation to get at the root of the matter.

Now, obviously, we respect proprietary information and keep it segregated, we understand that concept and that is what we as enforcement officers do as the Attorneys General of this country, and it is about time the Justice Department of the United States of America stands up and takes its role and understands the seriousness of what we are talking about.

We have allowed mergers and acquisitions to occur across many industries in this country, including the oil industry, so that now many of the classic antitrust analyses may not sit down, because if you only have a few companies you do not have to sit in the same room to fix prices the way they did years ago. There are other ways to do it and I think our Justice Department must stand up and take care of this problem. I think it is important. I have called on the Attorney General of the United States to do that, and many others have testified before you saying the same thing.

Finally, Senator, let me just simply state one simple fact, that the poet T.S. Elliot was wrong. For thousands of Maine people, it was December that was the coolest month.

Thank you.

Senator **Lieberman**. Thank you, General.

General O'Neil, of Rhode Island.

TESTIMONY OF JAMES E. O'NEIL, ATTORNEY GENERAL, STATE OF RHODE ISLAND [1]

Mr. **O'Neil**. Senator Lieberman, I can only echo many of the good thoughts and wishes shared by my colleagues from Connecticut and Maine, but let me add my voice to theirs and say to you, Senator Lieberman, it is a distinct privilege and pleasure to appear before you and the members of the committee and to see you in the leadership capacity as a United States Senator. That is a very personal joy that I would share publicly, to see this kind of leadership come about that allows us to join in unison in one voice to say that the consumers of America have a major problem and have encountered essentially a disaster and what we in government are going to do as we work in concert with one another.

I have testimony that has been prepared and distributed to your staff earlier. I would simply incorporate every word of that by reference herein and simply share some thoughts with you, in order that I act in the interest of time.

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[1] See p. 336 for Mr. O'Neil's prepared statement.

One thing is quite clear, Senator, with respect to the State of Rhode Island, that we have been certainly victimized by the oil industry this year. On June 23, 1989, we witnessed the *World Protege* oil spill. I can see it from my bedroom window, sir. That was coupled by the increase in prices that caused our consumers to have to pay approximately, as you articulately pointed out earlier, about 56 percent more in costs that were incurred to heat their homes, which is obviously one of the basic necessities that we all have to meet. We talk about first a spill and then a bill, and I am here today to say to the oil industry that it is time for them to bear up to their responsibility.

I did have a meeting in my office with the wholesalers of the oil industry who serve the State of Rhode Island and I cannot say this for certain, I want an opportunity to explore it a bit, but one of the wholesalers did share with me the fact that the owners of the *World Protege* group of ships that service the country had refused to come into the Port of Providence during this crisis of December, for fear that we would actually arrest the vessel, in satisfaction of our civil action that we are initiating with respect to the spill and litigation following thereafter. That clearly would not be the truth of the matter. If we wanted to arrest a vessel, we could have done that with the *Protege* last June. In the interest of the State as a whole, we elected not to do so. So, I find little excuse for not being served by any facet of the industry, if in fact that is the truth of the matter.

I think what we have before us is a very threshold issue and that is whether we in the business of government are going to conduct business as usual, which seems to be the prevailing air, more often than not, in the business of government. So, recognizing that you sought an alternative route, I certainly commend you, and I am optimistic that, when all is said and done, the answer to the question of whether or not the consumer will be continuing to bear the burden when phenomena such as this occur, or whether we will get to the root of the problem and insure that when an economic crisis does occur, that the burden is borne in an equitable fashion and not simply by the consumer, particularly when you look at the elderly of our Nation and those who are on fixed income, and the stories have all been told by those who preceded me before this forum. Obviously, it is the consumer who has borne the burden of this phenomenon, however the industry cares to color it.

I think certainly we recognize this business is a fragile one, when we talk about the commodities market and the mercantile exchange, and I do not pretend to be an expert in those areas, but I really wonder to myself aloud whether or not there have been any losers in that arena. There is a pressing question in my mind again whether the oil manufacturers could have foreseen conditions which promoted a climate of opportunity. When I say "foreseen conditions," I think they probably were in a better posture to do more than read the Farmer's Almanac, and I wonder if they did not just simply go for the gold when the opportunity was there.

I cannot reach that conclusion, but we know there are 19 manufacturers of the product, so perhaps there is collusion. I cannot say that and neither can you today, sir. I think Senator Chafee well hit the nail on the head when he said we have to investigate, and that is the process that you have begun and, again, I commend you on that. We have to determine whether or not there has been illegal collusion.

With respect to our initiatives at the State level, I must apologize and say to you that, with respect to our resources in the State of Rhode Island, they are limited. We have jurisdiction to a certain degree, but if there is ever an issue that cried out for a Federal response, this is the issue. It is certainly an issue which has impacted the Northeast in greater dimension than any other area of the country, but, nevertheless, it has impacted the entire Northeast, and the economic spinoff and the negative facets will be felt by the entire Nation, I am sure.

So I am here, as I said, to add my voice to yours in urging the United States Department of Justice, such as you did and Senator Rudman did and Senator Cohen did and Senator Levin did, in urging Mr. Rill from the Department of Justice to get on with a good, aggressive investigation. And I would ask that the Department of Energy and our former colleague join in that, John Easton, join in that initiative.

It is critical. It is critical so that we avoid this in the future and it is critical so that the people have faith and confidence in the business of government to lead and simply not to manage our business.

Thank you.

Senator LIEBERMAN. Thank you all. Your statements have been predictably excellent. I wish we had the same sense of consumer advocacy from the Justice Department. It troubled me this morning that all of us on the panel seemed to have to push the head of the Antitrust Division to be more aggressive in investigating and I thank you for bringing that mood of concern for the consumer here.

Let me ask you a couple of questions. Based on your own work at the State level, do you at this point have a sense of confidence that the retail price of oil is, in fact, dropping commensurate with the drop in the wholesale oil prices?

Mr. TIERNEY. It is going down.

Senator LIEBERMAN. Enough, General Riddle?

Ms. RIDDLE. I am not certain enough yet to know if there is the correct speed.

Senator LIEBERMAN. Right.

Mr. TIERNEY. Of course, there is no guarantee that it is not going to go up again. I think one of the earlier remarks, the first time since 1917 we may have had a cold December, I guess why don't we check out January and February, we use oil in those months, too, I thought that was disingenuous, at best.

Senator LIEBERMAN. I agree, this is not just once in a century experience. Clearly, there was a price rise after the *Exxon Valdez* and in 1983–84 we had a major price rise, and if the inventories of home heating oil continue to drop, this is just going to keep happening over and over again.

General O'Neil, have you had any——

Mr. O'NEIL. I would simply say that we do notice a decrease in the past week, but as others, I wonder whether or not that will be in place in the future. When you reflect on gasoline prices, I think we all remember standing in line and we all remember the shortage, we remember the $1.25 and $1.37 a gallon, and it seems that we get used to these prices, because if you look at the price of gasoline today, it is $1.06, $1.10, and it is almost like we are being softened up for a greater punch, so I think we should proceed cautiously in accepting the price is going down.

Senator LIEBERMAN. This may be premature, but based on what you know now, do you think that there may be a cause of action here under the Federal FTC Act or the little FTC acts for price gouging? Does anybody want to hazard a response?

Ms. RIDDLE. Well, we do not——

Senator LIEBERMAN. We did not really get to push Mr. Rill on that one.

Ms. RIDDLE. No. We know that there are a couple of cases in New Jersey and New York that help us to say that that is an aspect that we are going to look at under our FTC. It is the *Okun* v. *FTC* case, that we can refer to the committee staff. I at least think it is worth looking at. If we can use our little mini-FTC's to look at the question, it seems that the FTC could look at them.

Senator LIEBERMAN. Either of you?

Mr. TIERNEY. I would just say, Senator, my reputation is such that I am not afraid of tackling uphill and tough battles, but I think this one clearly cries out for Federal action. That is why we have a Federal Government, and there are times when it has to be done.

Senator LIEBERMAN. General O'Neil.

Mr. O'NEIL. I share the same thought. As you know, in Rhode Island, we have unique jurisdiction where you are responsible for all criminal prosecutions. If I was going to commit staff resources to an initiative of that nature, I would have to double my staff, so let me say it is clearly a Federal matter and it ought to happen here.

Senator LIEBERMAN. We have heard a consensus, not universal but prevailing here today, about the importance of getting into this business of oil reserves, to make sure that we can cushion the impact of a less than adequate inventory in the market. From these early thoughts, is there a role for the States in this? Should the States have the authority to ask for reserves at the State level, or should it come at the Federal level, either through publicly-owned storage or through a requirement that the major oil companies to keep such reserves? General O'Neil.

Mr. O'NEIL. Senator, I would say that again needs Federal leadership, and I say that because the State of Rhode Island, and it may be true in Maine and Connecticut, we have seen any reserves that were there removed. We do not have any reserve tanks in place due to environmental concerns and also due to what some of the people in the industry point out as a tax problem that they experience, because they have their inventory in place and that is an issue actually that has not been addressed. I think the tax structure is such that, as you know, if they have that inventory in place, they are going to pay a property tax upon that, and so, therefore, they elect not to have any reserves, so I think the Federal initiative with some sort of incentives would be necessary for this.

Senator LIEBERMAN. General Tierney.

Mr. TIERNEY. I think, whereas I do urge this Committee to look at the idea of strategic reserves, if we step back for a second, I think in many ways this is an indication of failure and we have to consider it. I believe that the marketplace is the best way to hold prices down. I believe if there was sufficient competition within the industry, that some of the companies would, on their own, maintain sufficient reserves and read the Farmer's Almanac like the rest of us, because they would be able to make a dollar and that is the best way to do it.

But what has happened, because we have the difficulties, as the previous panel indicated, the underlying economics of the industry, we have serious problems and so there we end up with the governmental response of having the taxpayers actually pay or trying to figure out how to reserve oil against the weather and we are ending up with the government function which would be better suited by the marketplace, which is where I return again to my initial theory, that I think the Justice Department with a vigorous antitrust enforcement could perhaps minimize the need for that kind of thing, to make sure there is competition.

Senator LIEBERMAN. General Riddle, I have one other question about that unusual Connecticut statute that prohibits the creation of an artificial fuel shortage. Do you think that is a model for a Federal statute? Should we consider enacting something like that at the Federal level?

Ms. RIDDLE. I do. I do think it should be considered and looked at. Obviously, we do not have experience with it to see what our burden of proof will be, to tell you what all the problems are with it, we cannot tell you yet. We are getting an idea by reviewing it, because it does have a specific intent component which is going to have to meet that hurdle, but I do think it is worth study. I think it is an interesting statute. It does not require conspiracy, just unilateral action.

Senator LIEBERMAN. But what you would have to prove is that there was a conscious intent to maintain, in this case, an inventory that was beneath the level of demand?

Ms. RIDDLE. Yes, with the intent of increasing prices.

Senator LIEBERMAN. Okay. I have no further questions. I thank you very much for being here. You have added immeasurably to the hearing. I apologize that you had to wait so long, and I look forward to working with you in the years ahead on this and other problems.

Ms. RIDDLE. Thank you.

Mr. TIERNEY. Thank you, Senator.

Mr. O'NEIL. Thank you.

Senator LIEBERMAN. Mr. Kennedy and Mr. Kelly are the wind-up witnesses. Mr. Michael Kennedy is Chairman of the Citizens Energy Corporation, of Boston, Massachusetts; and Lawrence Kelly is Executive Director of Tri-County C.A.P., in Berlin, New Hampshire.

I double my apologies to you. If there is any comfort in it, the Chairman is still here. I know others are not. The cameras from C-

Span are here, so the people out in America are anxious to hear what you have to say, as I certainly am.

Mr. Kennedy, welcome and thank you.

TESTIMONY OF MICHAEL LEM. KENNEDY, CHAIRMAN, CITIZENS ENERGY CORPORATION, BOSTON, MA [1]

Mr. **Kennedy**. Senator, thank you very much for having me here. It is a great pleasure to be here before your committee on this important issue.

I am here in my capacity as Chairman of Citizens Energy Corporation, which is a nonprofit company established by my brother, Congressman Joe Kennedy, in 1979 to deal with the oil price shocks that occurred at the end of that decade. I would just like to note, Senator, I have heard you had some difficulty getting some oil executives in here for this hearing, because they thought there might be some tough questioning, so I would like to underline the fact that this is a nonprofit company that I work for.

Senator **Lieberman**. The questioning will be commensurately easy. [Laughter.]

Mr. **Kennedy**. Throughout the decade of the 1980's, we have been able to secure contracts from producing nations to bring the crude oil into refineries, have the refineries process the crude oil, reselling the products in the market and bringing the heating oil portion of that crude oil barrel up to Massachusetts for resale to the State's fuel assistance program.

We have provided the State of Massachusetts in the last 10 years over 36 million gallons of home heating oil at savings of 30 to 40 percent below market rates. During that period, we have branched out into a number of other areas, exploration and production, we have for-profit subsidiaries operating in oil distribution and oil trading, natural gas brokering and electricity brokering as well.

For the last 3 years, we have provided all of the heating oil needs for 36 homeless shelters across the State of Massachusetts. That program is conducted in conjunction with and cooperation with over 25 area fuel oil dealers, and so we know on a very close and first-hand basis the functioning of the fuel oil distribution system in Massachusetts.

Our perspective, therefore, is one of both an advocate and provider for those who are hit hardest by higher energy prices. We also are heavily involved in the market ourselves and try and make as much money as we possibly can, so we can serve more people at the end of the day. It is from that perspective that I join you today.

Let me just briefly sum up the testimony that you have been given in terms of from where we have been operating. Obviously, you have heard a lot about the physical dislocations that contributed to an increase in the market price in December, the cold weather, the low water levels in Europe, the low water levels in Canada, the freezing temperatures in Texas and Oklahoma that shut off some of the natural gas supplies. But from our point of view, obviously, it is the mercantile exchange that sets the price and, for good or for ill, that is the prevailing cause of the run-up in the prices, despite the physical dislocations that we saw.

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[1] See p. 347 for Mr. Kennedy's prepared statement.

You have not been focusing on the No. 6 residual fuel. That rose in December almost 70 percent. That fuel is not a consumer fuel, so it did not receive the kind of attention that you are focused on today, and the fact is that, because residual fuel is used by the consumer, it perhaps should not be the object of this kind of speculation that exists on the mercantile exchange. That is a question for you all to decide.

The effect of that kind of market speculation in the future will be a commodity fluctuation and that effect on poor people and elderly, on fixed incomes, is extremely magnified.

We have seen in Massachusetts a woman on Social Security, will receive $483 a month. If she survived the cold of December, she is facing getting her tank refilled, a 275-gallon tank, it is going to run her in excess of $325 at today's prices. How she can pay for the rest of her food and her shelter is beyond me and is unacceptable in today's America.

The solution to these problems are very difficult and there are no easy answers. Obviously, in February the price are coming down and an educated consumer is probably the best way we can make sure that the price comes down as quickly as it possible can at the retail level.

Conservation has never been a better bargain than it is today, but my third recommendation is probably the most important to this committee and that is there is a market mechanism out there that the Federal Government and State and local governments and community action agencies who are responsible for providing for those who are helpless in this kind of situation can utilize. They can ensure themselves through market mechanisms of a price prior to winter run-ups such as we saw in December.

Finally, we have heard speculation that the administration is proposing cuts in the LIHEAP fund, and we can only say and recommend that you use all the influence you have, Senator, not to make that a colder and harsher reality.

Thank you very much.

Senator LIEBERMAN. I accept that challenge, and I assure you that we will try to meet it. I know that your concern is shared on this committee in a bipartisan way.

Mr. Kelly.

TESTIMONY OF LAWRENCE KELLY, EXECUTIVE DIRECTOR, TRI-COUNTY COMMUNITY ACTION AGENCY, BERLIN, NH [1]

Mr. KELLY. Let me begin, Mr. Chairman, by stating for the record that I take great comfort in being here.

Mr. Chairman, I am Lawrence Kelly, Director of the Tri-County Community Action Agency, which administers programs, including energy programs, for the low-income residents of New Hampshire's north country. Much of our area has missed the rapid growth which has recently characterized the southern part of the State and much of the economy is seasonal.

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[1] See p. 357 for Mr. Kelly's prepared statement.

Along our winding mountain roads are declining mill towns, closed businesses and isolated families and older people facing present threats and inadequate future opportunities. We are used to long cold winters, but this year's brutal weather has caused great suffering already. December had 22 percent more heating degree days than is normal. Oil, our main heating fuel, went from 81.9 cents a year ago to over $1.44 a gallon. A tank of oil costs $398 now, and the average fuel assistance benefit of $410 covers that plus 8 gallons more. Last year, with higher benefits and lower costs, LIHEAP could pay for two tanks of oil and to see families through January.

Applications are up 20 percent over last year and our offices are deluged with calls and visits from people without fuel. Because of LIHEAP reductions over the past 4 years, we have far fewer offices in outlying areas, nor have we staffed anywhere adequate to meet this need. The reduced fuel assistance level means that people we have helped face the balance of the winter have no further place to go.

Mr. Chairman, let me try to describe in human terms the nature of the suffering we are experiencing right now. Among our clients who have exhausted all their fuel assistance benefits are a disabled client participating in our vocational rehab program who was recently hospitalized for hypothermia, after she tried but failed to heat her trailer with her oven.

A single mother in her thirties, her toddler has just been taken away from her by the State welfare office, because the heat and electricity were off.

The unemployed, a 48-year-old Vietnam vet whose mobile froze up and is now uninhabitable, he has moved into a neighbor's old cellar for the winter.

A 90-year-old widow heats with a wood stove and has no indoor plumbing. Numerous renters are now facing eviction because they cannot pay their rent and heat.

I might also say that we have had literal fire sales of the kind described by Senator Cohen earlier this morning, and people, including the elderly, are skipping meals, disconnecting telephones and turning thermostats to 50 in order to pay the oil dealer. Many are buying fuel oil at the dealers in 5-gallon cans.

The survival of their homes depend on these choices, as the alternatives to the sacrifices that they are presently undertaking is, in fact, homelessness. We have done everything we can to find supplemental funds. We have raised about $30,000 in State, town and FEMA money.

Our major utility is bankrupt and has provided no help. Our small churches do their best, but this is not enough. We face a disaster in February if the temperature returns to normal for the season. Unfortunately, forecasts are for abnormal cold. In fact, Mr. Chairman, yesterday the thermometer in Berlin was 9 below. And while that is not as cold as it has been in December, that is now how you spell relief.

We need at least 25 percent more in fuel assistance funds just to use for people in crisis, or about $300 million nationally, and we need a long-term approach that can defend the poor against this fearful and perhaps tragic situation. We know how to effectively administer energy programs in concert, combining weatherization, LIHEAP and home repair, with the result that permanently makes the client's home far more energy efficient.

An adequately funded program, including these elements, can tighten up the home, train the client to maintain a structure system and to use energy wisely and provide a modest base of support where it is still needed. The quality of housing would be improved, while costs were lowered and energy demands went down. The market economics is extremely complex, but I think I know that one of the ways to lower costs is to lower demand, and one of the ways to lower demand is through energy conservation on the household level.

We do this now but only for about a dozen families in the past year. We were able to reach approximately 300 homes with weatherization alone, but our waiting list is nearly 700, and it is stretching toward a 2-year wait. We could, in fact, double that waiting list without half trying if I did not urge my staff not to let too many people know that the possibility exists that they can participate in this program, because of the ensuing 2, 3 and 4-year wait would cause more anxiety and difficulty than their inability to provide for the program as it is presently constituted.

Mr. Chairman, our senior Senator, Senator Rudman, has long been in the front lines defending the LIHEAP weatherization program. We recognize and we appreciate this fact. We thank our close and good neighbor, Senator Cohen.

We also welcome and are deeply grateful for your own and this committee's compassion and concern. On behalf of the Nation's community action agencies, I urge you to send us some supplemental relief in this year LIHEAP program and adequate funding in both low-income energy programs in the future.

Senator **Lieberman**. Thank you, Mr. Kelly.

I must say, listening to the two of you, that I found both your statements compelling and constructive. Maybe if I did this hearing over again, I would reverse the order and have the two of you first.

I appreciate the comments you made, Mr. Kelly, about energy conservation. Though we are concerned here with what we are calling a price spike, the reality is that we are dealing with a non-renewable energy source and, as time goes on, clearly in this and so many other ways we are going to have to learn how to use less of it.

Mr. **Kelly**. It is one more spike in the coffin.

Senator **Lieberman**. It is one more spike in the coffin, you are absolutely right.

Mr. Kennedy, you suggested in your statement that speculation on the Mercantile Exchange in New York on oil futures was somewhat responsible for running up the price of oil during December. Expand on that a bit and tell me if you think that there is anything—I gather that you are not against the MERC—is there anything you think we should do to regulate the MERC to protect us from that kind of speculation?

Mr. **Kennedy**. Well, certainly I do not think anybody can deny that the physical dislocations that do occur are expanded and in a speculative market situation. That is true, whether you are dealing with soybeans or oil. The tough thing is that heating oil happens to be a consumer commodity and in the very human situations that we face, that is a very, very difficult reality to deal with, much less on a general consumer basis. Some of us can afford a price increase on a month's basis, but some people just cannot afford that and so there should be a public policy question as to whether that kind of basic necessity should be under the same kinds of speculative pressures that orange juice is under.

Senator **LIEBERMAN**. It sounds to me like you think maybe not. Am I correct?

Mr. **KENNEDY**. Well, it is a very open question in my mind. I do know that if it is the reality, there are certain things that people like Mr. Kelly can do. The fact is that the Federal Government is the biggest speculator in the market and they speculate at the exact wrong time.

Senator **LIEBERMAN**. Say a little bit more about that.

Mr. **KENNEDY**. You are facing a situation in Massachusetts of buying 23 to 25 million gallons of heating oil across the winter season and you are buying it at the exact end point, you are shorting the market, essentially, and so what we would suggest——

Senator **LIEBERMAN**. Buying it for Federal facilities, you mean?

Mr. **KENNEDY**. No, buying it for——

Senator **LIEBERMAN**. For LIHEAP.

Mr. **KENNEDY** [continuing]. For community action agencies who ultimately get the oil out to the people, so you are playing the market, there is no question, and you are playing at exactly the wrong time.

Senator **LIEBERMAN**. So, the government is playing the market, but not doing it intelligently?

Mr. **KENNEDY**. That is correct, and so there are some sophisticated, actually not that sophisticated, methods to hedge your bets to insure that if a price spike occurs, that you will not be quite the victim that we all were in December.

Senator **LIEBERMAN**. What do you think about that, Mr. Kelly? Should we be more active and more intelligent in the market?

Mr. **KELLY**. Well, we have stumbled into bad times this time. The national program has stumbled in good times at other times, usually it has just stumbled. I do not believe that the kinds of initiative Mr. Kennedy is indicating, that the large quantity of oil that you buy would allow us to pursue have in fact been considered, and we would welcome that kind of consideration.

We have on the local level and at various State levels pursued different kinds of collective again, whether it be consumer discounts at a fixed price basis, as they do in Maryland, buyer co-ops like they do in Pennsylvania, or in the north country of New Hampshire, we have been able to develop a consortium, including all of the local fuel oil dealers and persuaded them, both through the goodness of their heart and also the leverage that this program gives us, to grant discounts better to the low-income consumers than the kind that upper-income consumers are used to and previously unavailable to the low-income consumers.

Senator **LIEBERMAN**. But that consumption is not jointly purchasing oil or entering into the mercantile——

Mr. **KELLY**. No, that is not something that we have been able to look at and it is something we would have to look at the larger picture that we are able to. It is possible that we could look at it at the State level, but the way the program is structured at the present time it is not possible. If we had that kind of an arrangement this year and then found out that, in fact, the LIHEAP funds did not come until seven weeks into the beginning of the fuel season, I think we would have some problems with the oil people with whom we contracted, and it is that kind of national difficulty that has hedged our ability to be more flexible than we have been locally. As I say, the kinds of things that we can do on less than the national level we have done, and the kinds of things Mr. Kennedy is suggesting that we look at, we are eager to look at.

Mr. KENNEDY. I would just say that in Massachusetts, I know that the State is the largest single purchaser of home heating oil and they continue to pay market rates, retail rates for all the money that they pour into the market. They have experimented with a couple of different programs, but those are again tied to the daily price at the rack, and so you will be affected by the price spike.

What I am suggesting is slightly different in that you might at the beginning of the season look at your budget, particularly if you are a small community action agency, be able to say I only want to spend X amount on heating oil and not spend more than, let's say, a dollar. You could have done that at the beginning of this season and effectively implemented such a program. Like any insurance policy, it is going to cost you money, but that in today's market, where the only stable thing about today's market is it is going to be fluctuating probably makes the best sense.

Senator LIEBERMAN. Let me take advantage of the unique role that your organization has, both nonprofit activities and also substantial acquisitions of oil for profit, to ask your personal opinion about where all the money went, this question that we keep asking. We paid a lot more. Who got it?

Mr. KENNEDY. Well, we all made money in the oil industry. Citizens had a good month and, at the other end, we had to provide a great deal more funds for people who were crying out in a great deal of pain, so we do have that, as you say, different look at this.

I would say it was divided across a couple of different sectors, mostly in the refining end. I am glad to see our colleague from Texaco present here to answer some of your probing questions. I think that is probably where most of the profit was taken.

On the other side, the refining business was not a very good business a few years ago, so perhaps that is taken into account by you when you decide some of these public policy questions. Certainly, it is appropriate to look into some of the antitrust questions that the previous panel were discussing to see if there was collusion or some fore-knowledge, but I do not think you are going to find too much of that, frankly.

Senator LIEBERMAN. Thank you, Mr. Kelly and Mr. Kennedy both. I hope for some real results from this hearing, but certainly one result is that I, and I sense everybody else who was up here, are going to try to make sure that at least no one is freezing because of the run-up in prices and the lack of home energy assistance.

Talk to me a little bit about the dimension of the need and how soon you think it is necessary for more funds to be in the pipeline.

Mr. KELLY. Our particular situation, and it is certainly not unique to New Hampshire or the Northeast, is that our regular program is going to terminate in 10 days.

Senator LIEBERMAN. Ten days from now?

Mr. KELLY. Ten days from now, at maximum. If we get another run of 9, 10, or 15 below, it will be a little sooner. If it drifts back up to comfortable temperatures like 10 above, we might make it to February.

Senator LIEBERMAN. And the cold season in New Hampshire goes to when, would you say?

Mr. KELLY. April.

Mr. KENNEDY. June?

Mr. KELLY. If you want to talk about the cold season, really, instead of the heating season, Mr. Kennedy is right.

Senator LIEBERMAN. So, what is going to happen to those people who are not going to get funds? Does this mean that those grants are not going to be there?

Mr. KELLY. That is right, they are going to be used up. We will have a small amount of emergency funding left. It will not begin to meet the need. I think Mr. Kennedy earlier said he did not know what was going to happen to those people. I have got a better idea, but I am not any more comfortable with it than he was. We are going to have to go to towns that are unprepared to deal with this and we are going to have to say there is nothing more we can do, this person will die unless you provide this person with emergency town relief, and they are going to look at us like we crawled out of the grave and say, "How am I going to explain that at the town meeting?" and I am going to say, "I don't know, but you've got to do it," and we are going to have to do that to 72 towns and I do not know where I am going to get the people to meet the people who need the help to get to the towns who are not prepared to deal with this, many of them being small and remote and are not really capable of doing it without help.

I could go on and on, but the end of the road is we have got a serious problem, we need the kind of help you have indicated you understand we need as soon as possible. I am not kidding.

Senator LIEBERMAN. I hear you.

Mr. Kennedy, do you want to add anything?

Mr. KENNEDY. I know that Massachusetts, at the end of December, 2 weeks ago, was running 10,000 applications in front of where they were at the same time last year, so my example of the woman on Social Security may be anecdotal, but it is certainly out there, it is not an exaggeration.

We will continue, even though the price has hit us on the homeless shelter side significantly, we are going to continue to provide those shelters with our commitment throughout the winter. As I say, the fuel oil dealers are all foregoing their normal profits in distributing the oil to the shelters, so from our perspective on that end of things, I did not see them price gouging, either.

Senator LIEBERMAN. What both of you are saying so clearly is that, if we think what happened in December as an earthquake, there are going to be after-shocks. We are going to feel it at the level of those who are least able to pay, and all of us, I suppose, are going to feel it as a consumer goods increase in price as a result of increases in business costs and transportation costs.

I have no further questions. Do either of you want to add anything?

Mr. **Kelly**. The only thing that I would add in conclusion is that, as eager as we are to participate in innovative programs of the kind that was just discussed here and as seriously as we take the responsibility to develop long-term solutions, we can do neither without the means. It is very hard to see either today without short-term help to meet the immediate emergency situation.

Thank you, Mr. Chairman.

Senator **Lieberman**. I thank you both. I thank everyone who has participated in the hearing. I feel confident that we have added to our general understanding of what happened in December.

Frankly, some of the witnesses from the industry disappointed me. I do not believe that we got the kinds of answers that satisfied our question about where all the money went and how we can avoid these problems next time. But there have been some very constructive recommendations made by others along the way about the involvement of consumer groups in the market, about the product reserve, and particularly about the immediate need for LIHEAP aid.

I thank you all and at this point we will adjourn the hearing.

[Whereupon, at 2:05 p.m., the Committee was adjourned.]

APPENDIX

News From
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RHODE ISLAND
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For Immediate Release
January 16, 1990

For Further Information:
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STATEMENT BY
SENATOR JOHN H. CHAFEE
BEFORE THE SENATE GOVERNMENTAL AFFAIRS COMMITTEE ON THE RECENT INCREASE IN HOME HEATING OIL PRICES
Tuesday, January 16, 1990

Thank you, Mr. Chairman, for holding this hearing. Let me also welcome Rhode Island Attorney General James O'Neil to Washington; his report will be extremely helpful.

As we all know, the national price-- both wholesale and retail -- of home heating oil has skyrocketed during the month of December, 1989. For New Englanders, the effect of this price hike has been particularly severe.

According to the Rhode Island Office of Energy Assistance, Rhode Islanders paid an average of 97 cents per gallon of heating oil on December 4. Two weeks later, the price per gallon jumped 11 cents, to $1.08. Within another eleven days, a gallon of heating oil could not be had for less than the staggering price of $1.51. In other words, the retail price of home heating oil went up 56 percent in 25 days last month.

Wholesale prices didn't fare any better. By December 29, suppliers were rushing to buy oil at $1.26 per gallon -- an 88 percent increase in price from December 4 prices.

We can recite figure after figure, but my first and foremost concern is the effect of this increase on consumers. An average Rhode Island household burns about 800 gallons of heating oil annually. As a result of the steep prices, the typical family may be looking at extra heating costs of up to $400 this year. That is no small financial burden.

Can the average household afford the extra cost? Some can, and some can't. Energy costs are fixed -- rich or poor, one pays the same price per gallon of oil. That means fixed or low income families suffer more when prices go up, since the increase takes a larger bite of their income.

National Consumer Law Center analysts estimate that the average Rhode Island widow\er living on a $488 monthly Social Security check pays $80 per month -- 16 percent of his or her income -- on energy.

Last Friday I received the following letter from an elderly couple in Cranston:

"Dear Senator Chafee: I am writing this letter to you in regards to the price we are paying for fuel oil.

My wife and I are in our seventies and living on a fixed income. We received a delivery of oil on December 5 for which we paid 99 cents a gallon.

On December 28, we received a delivery of oil for which we paid $1.59 per gallon. We do not think this is fair..."

As have my colleagues, I received dozens of other letters just like this one in the past seven weeks.

A "heat or eat" choice is no choice at all. In 1980, we in Congress took steps to help erase this inequity by enacting the Low Income Home Energy Assistance Program (LIHEAP) . LIHEAP is a good program and I have long supported it. But LIHEAP cannot aid all of the 85,000 Rhode Island families that qualify.

Across the nation we are experiencing record cold temperatures this winter; December 1989 broke every Rhode Island cold weather record for December since 1917.

In addition, refinery production difficulties, market speculation, and lack of substantial oil inventories, may share the blame.

However, in spite of these events, I remain deeply concerned about the possibility of fraudulent pricing practices. I also recognize that most of the home heating oil dealers in New England are just as bewildered as consumers are about the increase; and they are bearing the brunt of the consumers' anger.

What I want to find out is: were those heating oil price increases brought about by illegal collusions? If they were, then I want those guilty persons to be punished.

If they stole $400 from every Rhode Island family, they would surely be punished. Likewise, if they illegally cause every Rhode Island family to pay $400 more for oil than ordinarily should be true, then they too should be punished.

We are now seeing retail prices come down to $1.29, and wholesale prices drop to 89 cents. However, we should keep in mind that the resident who bought 275 gallons of oil for $1.51 per gallon now has enough oil for 3-4 weeks. Thus, the recent drop in price does not yet make any difference to that resident; he or she has already paid peak costs.

Mr. Chairman, I hope we are able to receive some enlightenment from the knowledgeable witnesses you have assembled here today.

Thank you.

STATEMENTS OF

JOHN J. EASTON

ASSISTANT SECRETARY FOR

INTERNATIONAL AFFAIRS AND ENERGY EMERGENCIES

and

HELMUT A. MERKLEIN

ADMINISTRATOR

ENERGY INFORMATION AGENCY

U.S. DEPARTMENT OF ENERGY

BEFORE THE

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

JANUARY 16, 1990

Mr. Chairman and members of the Subcommittee, Dr. Merklein and I are pleased to be here to provide the Department of Energy's views about the consequences of the recent extraordinarily cold weather on energy markets, including the price increases that have affected consumers in many parts of the country in recent weeks.

I want to stress that at the Department we view the events of the past few weeks with great concern. They have affected individual American consumers and the economy as a whole. We are most sensitive to the hardships that the rapid and unexpected increase in demand for heating fuels and the sharp rise in energy prices caused, particularly for small businesses and people with limited or fixed incomes. I also want to say that the current tight market conditions are beginning to ease as additional supplies of product flow into the regional markets from domestic and offshore sources. This increase in available supplies should exert a downward pressure on wholesale and retail prices.

I'd like to begin by asking Dr. Helmut Merklein, Administrator of our Energy Information Administration (EIA), to describe the present energy supply and price situation and how it evolved and to give his judgment of what lies immediately ahead. I will follow Dr. Merklein's discussion with a summary of our activities to respond to the situation.

Summary Assessment of Heating Fuel Markets

Helmut A. Merklein

The Department of Energy has conducted an assessment based on preliminary Energy Information Administration data of heating fuel markets, focusing primarily on heating oil and propane. The analysis confirmed that wholesale and retail No. 2 distillate, as well as propane prices, increased dramatically over the period from early August through the end of December, with the bulk of those increases occurring in December, largely as a result of near record cold weather.

Before reviewing the results of our preliminary analysis I want to inform this Committee that in response to concern over reports of fuel oil and propane shortages and escalating prices, and as a follow-up to an earlier hearing before the House Subcommittee on

Energy and Power, the Energy Information Administration has agreed to do two analyses. A short-term analysis dealing essentially with prices and margins that are available either from public sources or from EIA's own data bank will be completed and results will be released before the end of January. It is the purpose of this study to provide quick information concerning the dramatic price increases of heating fuels in late December. As always, there is a trade-off between speed and accuracy, and it is speed that dictates the preparation of the short-term analysis. Analysts who plan to use this study should not expect definitive answers to flow from it.

Using EIA's own data in conjunction with credible information from non-Government sources, EIA will also do a long-term analysis to describe the December pricing phenomenon of heating fuels. Much of the information EIA collects is assembled in monthly cycles. As general rule, the respondents are given 4 weeks to close out their books and forward their data to EIA, where an additional 4 weeks are required to edit, verify, assemble and print this information. Thus, on a monthly collection system, data availability usually lags by about two months.

EIA's long-term analysis is expected to be scrutinized by local and federal law enforcement agencies. This being the case, it is imperative that all data, including profit data, be included. As a result, we will hold back publication of the long-term in-depth study until after the first Quarter of 1990, when 10-Q Forms have been filed with the Securities and Exchange Commission. I realize that this will appear to many to be an inordinate delay. That is why the short-term study, designed to meet the immediate concerns of the public, is being prepared, while the long-term analysis will be done with the deliberativeness and thoroughness that the occasion demands.

The results of our preliminary analysis show that wholesale spot prices for No. 2 heating oil in New York Harbor rose $0.68 per gallon to $1.15 by December 27 from the $0.47 level seen in early August. Of this increase, $0.53 occurred in December. Residential prices for heating oil also climbed; for the nation at large, they rose by about $0.30 per gallon from August through December, $0.24 of which occurred in December. This was, however, no consolation to consumers on the East Coast (PADD I), where prices in December rose by $0.45, reaching about $1.40 per gallon, on average, and considerably higher locally.

Residential propane prices also rose sharply in December. By January 2, residential prices in New York had climbed $0.33 per gallon in less than three weeks to $1.40. In the Midwest, price increases were similar. For example, in Ohio, comparable propane prices rose $0.30 per gallon in the second half of December.

Although numerous factors combined to generate these sharp price increases, by far the most important was demand, which in the case of distillate increased almost 1.0 million barrels per day (MMBD), or 33 percent, to 4.1 MMBD at the U.S. level in December. This surge was the largest one-month increase in at least a decade (most of which occurred on the East Coast) and more than double that seen in December 1983, when prices also rose sharply in response to a sudden cold snap.

The enormous increase in heating fuel demand was generated by the unexpected, widespread cold wave, which blanketed most of the U.S. in December. On a heating degree basis, December was 27 percent colder than normal nationally (and 29 percent colder than last December), and 33 percent colder than normal on the East Coast (the coldest December in at least 60 years).

Supply factors, to a lesser extent, also contributed to the distillate price increases. U.S. primary distillate inventories at the end of October (the outset of the heating season) stood at approximately 121 million barrels (MMB), 7 MMB lower than last year's level, but the same level as 1987. Apparent causes include a prevailing downward trend in distillate stock levels over the past decade, due to various financial disincentives. The declining share of the seasonal heating component of total distillate consumption also contributed to the downward trend in distillate stocks. On the East Coast, distillate inventories at the end of October were 5 MMB lower than last year's level of 57 MMB, but only 1 MMB lower than the year before.

Even though beginning-of-the season inventories of distillate have trended down over the years, end-of-season inventories (end of April) have been remarkably stable over the last seven years. They fluctuated from a high of 103 MMB in April 1983 to 95 MMB in April 1988. This compares to a minimum operating level, as determined by the National Petroleum Council, of 85 MMB.

Prior to the heating season in late September, primary propane stocks were 60.5 MMB. While this was about 4 percent below stock levels at the same time last year, it was 3.7 MMB more than in 1987 and 3.8 MMB more than the level in 1985. In less than three months, this national inventory dropped to an estimated range of 37 to 45 MMB -- the lowest in 20 years according to industry sources. The December drawdown alone was estimated at between 13 and 16 MMB. This was only the fourth time since 1969 that December's drop in propane stock was greater than 9 MMB.

The increased demand for heating fuels brought on by the cold weather resulted in short-term transportation bottlenecks. Typically, suppliers allocated sales to contract customers, and, in some cases, suspended temporarily all spot sales, thereby exacerbating upward spot price pressures.

In addition, during the last two weeks of December, a number of refineries were completely shut down or had reduced operations due to the cold weather and/or fires and explosions. Spot markets for distillate jumped $0.22 per gallon in two trading days on news of these refinery problems.

In contrast to the distillate market, were prices escalated but physical shortages failed to materialize, outages did occur in the propane market. By December 21, many propane suppliers were experiencing outages, especially in the Northeast, the upper Midwest, and as far south as Kansas and Tennessee. Unlike No.2 distillate, propane supplies were being drained faster than they could be replenished. December product was reported to be unavailable on spot markets and virtually all suppliers began to limit sales to contract customers at minimum allowable volumes. To assure continued supply for residential accounts, it was reported that "lower priority" customers in commercial or industrial categories were cut off selectively..

With the return to near normal temperatures across most of the Eastern half of the country, the distribution system is recovering and demand seems to be returning to more normal levels. Production is expected to regain much of the volume lost during the cold snap. Additional supplies will also result from sharp increases in imports during the month of January. Distillate stocks have already begun to recover; during the first week of January, they grew by 2 MMB nationally, and by 1 MMB in PADD I.

Although decreases in refiners' wholesale distillate prices are expected to follow the spot market drop of $0.40 per gallon by January 10, there are likely to be lags on the reduction of retail prices. Distributors that were forced to purchase inventory at the high prices reported in late December may attempt to recoup these costs as long as residential demand persists. Nevertheless, on an inflation adjusted basis, U.S. residential prices in December were still $0.68 below (38 percent less than) the all-time high level which occurred in March 1981. Furthermore, residential prices in New England, the Mid-Atlantic States and the Midwest have already dropped $0.16, $0.07, and $0.03 per gallon, respectively, since the beginning of January.

Propane is expected to follow the same pattern as distillate. In the first week of January, terminal prices fell from $0.14 to $0.17 per gallon in the middle of the country, closest to the source of production. Meanwhile, a decline in terminal prices in the Northeast and upper Midwest and in turn, prices to residential customers, may follow suit as higher-priced inventory is cleared out of the distribution system.

I have included a more detailed assessment of these factors as an attachment to this statement.

Now that Dr. Merklein has discussed the factors that brought about the tight product supply market and the recent price increases, I will review some of the Department's activities in response to these circumstances. I would point out that preparedness for an emergency is a continuous activity and the Department's initiatives over the past several years proved extremely helpful in December.

By mid-December the Department began receiving reports, particularly from its contacts with state energy officials in New England, that low heating fuel dealer inventories could cause problems if the extremely cold weather continued. Heating degree day accumulation for this year's heating season was far in excess of the comparable period for any recent heating season. At the same time, we also received reports that a propane supply shortage was developing in New England.

State energy offices in Kentucky, Ohio, and Missouri, were reporting similar problems with propane supplies. Other regions were concerned that the unseasonably cold weather was beginning to affect the availability of No. 2 heating oil, propane and natural gas.

To gain a quick firsthand assessment of the magnitude of the problem and to identify any supply bottlenecks that could be alleviated by Federal or industry initiatives, I convened, at the direction of the Secretary, a meeting of federal, state and industry officials in Washington on Saturday December 23rd. The primary purpose for this meeting was to have these officials address the possibility of cascading energy supply problems (shortage of one fuel causing an inordinate draw on another), and to identify measures that we could undertake to mitigate any adverse impacts. We felt that by bringing together suppliers with state energy offices, natural gas suppliers with heating oil suppliers, propane suppliers with electric utilities - we could work together to keep the problem from getting worse, identify options for increasing locally available fuel supplies and explore the options available to help reduce the impacts of the tight supplies.

The December 23rd meeting began with a weather briefing by the National Weather Service (National Oceanic and Atmospheric Administration [NOAA]). NOAA confirmed that December 1989 was the coldest December in recent history (since 1917 for Washington, D.C.), and that unlike previous cold spells, multiple regions of the country were being affected simultaneously.

Representatives from the major energy industry groups (American Petroleum Institute [API], National Propane Gas Association [NPGA], Interstate Natural Gas Association [INGA] and American Gas Association [AGA]) indicated that constraints in the distribution network were the principal problem and that supplies to the nation as a whole were generally adequate. The major refiners and pipeline distribution systems indicated that in general their facilities were operating at maximum capacities. In other words, despite some local and regional tight supplies it was not so much a question of the adequacy of supply but rather one of distribution. There simply was not enough transportation capacity to get the supplies where they were needed fast enough to respond to extraordinary increase in demand caused by the cold weather.

At this meeting state energy officials were able to interact directly with senior executives of energy supply and distribution companies as well as representatives of national energy associations. This was extremely important in giving them a perspective of what was happening throughout the entire energy system and allowed for a better understanding of the causes of the impacts they were seeing at the local level in their states.

DOE was asked by the meeting's attendees to "stay on top" of the situation and disseminate complete information to all participants. In addition, DOE committed to work with the appropriate federal and state regulatory authorities to reduce any regulatory impediments affecting the flow of energy supplies. To that end, we worked with various federal agencies and local authorities in an effort to obtain Jones Act waivers to facilitate product movement by foreign-flag ships; to relax tank-truck driver hour limitations; to expedite critical refinery feedstocks through congested ports; and to expedite rail and motor shipments of propane and home heating oil to the northeast.

One example of our attempts to remove any regulatory impediments to the movement of available supplies to the affected markets is in seeking to gain exemptions from the statutory requirement that seaborne transportation between two US ports be carried in US flag vessels, commonly known as the Jones Act. Under Public Law 81-891 (Dec.27,1950), the Jones Act can be waived on a case by case basis " when necessary in the interest of national defense"; a waiver is mandatory when requested by the Secretary of Defense, but discretionary on the part of the Secretary of the Treasury (who acts through the Customs Service) when requested by any other federal agency.

As I have indicated previously, there were additional supplies of propane and distillate available on the Gulf Coast; however the industry indicated that there were no US flag vessels available for immediate charter to transport these supplies to New England.

The first of six Jones Act waiver requests was filed with the Customs Service on December 21, 1989 . In each case, the Customs Service formally requested DOE's advice on the need to approve the applicant's waiver request. The Department supported all of the requests. Of the six requests received three were for propane shipments, two for distillates and one for residual fuel oil.

As of this date, two requests for waivers of the Jones Act have been granted. The first request was filed on December 23 by Bay State Gas Company for the shipment of 100,000 barrels of propane to be delivered in equal amounts to a terminal in Philadelphia and a terminal in Newington, New Hampshire. Late in the day on December 28, a limited waiver was granted by Customs. However, by this time the Danish-flag tanker available for charter had already departed for a foreign destination. A second waiver was granted to Sharpgas on January 10, 1990. The waiver was granted after two previous requests by Sharpgas were rescinded because the designated vessels had departed. It is expected the propane will be delivered to Chesapeake, Virginia about January 22, 1990.

In order to ensure that in the future that the Government can respond quickly to requests for energy-related Jones Act waivers, I am convening a meeting of the agencies involved. The purpose of the meeting is to identify the specific information each agency needs for it review of waiver requests, to work out ways to expedite waiver request reviews, and to identify how we can facilitate coordination during emergencies.

Another example of DOE's actions to remove regulatory impediments to increasing the distribution of available supplies was requesting the Department of Transportation to grant waivers on hours of service restrictions for drivers of propane tank trucks. This served two purposes, it enabled individual companies to increase their deliveries to their local customers, and it also enabled them to dispatch trucks to distant terminals to pick up additional volumes of product.

In addition, in December DOE issued two emergency orders under section 3 of the Natural Gas Act authorizing increased imports of Canadian natural gas into Vermont and Massachusetts.

Let me illustrate an example of the government/ industry cooperation that resulted from our efforts. On December 15th, the Texas-Eastern Pipeline had begun to prorate propane deliveries from their Watkins Glen distribution facility. This was done in response to the unseasonably high demand and their concern that premature drawdown of the propane stored in the Watkins Glen facility would leave them unable to meet all their projected demand later in the heating season. This terminal is supplied by pipeline and has a significant amount of storage capacity. Since local demand for propane during the winter heating season exceeds the capacity of the pipeline the difference is made up by a drawdown of stored inventory. The company fills the storage and builds inventory during the off season, when propane demand is lower and the pipeline has spare delivery capacity. After our discussions with the pipeline company, Texas-Eastern made a decision to supply additional volumes of propane from this facility. It must be recognized that there is some risk involved in this decision, since the inventories drawn from storage may not be able to be replaced during this heating season. If demand becomes unusually high later this winter there may not be enough supplies at this terminal to meet all the local demand.

The cascading events affecting our energy supply in December highlight how complex and interdependent our energy markets have become. Events and circumstances that impact one source can have widespread and profound effects on other fuel demands, which in turn can have adverse impacts on the production and distribution systems. For example, during times of peak demand, natural gas distribution companies may turn to propane to help meet customer demand. This unusual demand can create shortages of propane. Similarly, suspending natural gas service to interruptible customers, which are generally electric utilities and manufacturers, can result in large increases in petroleum product demand as these customers switch to distillate for their energy needs. A shortage of propane could significantly increase the use of electricity for space heating. A reduction of electric power caused by lack of capacity to meet a weather induced spike in demand (brown-out or black-out) could adversely affect oil production, refining and pipeline distribution.

Many of the problems we recently experienced were caused by two factors. One was the unusually severe December winter weather affecting many regions of the country simultaneously. The second was a rash of accidents and other problems which happened to occur at the same time. These include:

- Refinery operations cutbacks, particularly in the Gulf Coast area due to severe cold weather. Problems included frozen pipes, instrumentation and cooling towers. Operations of most Gulf Coast refineries were disrupted from several days to one week.
- The December 24, 1989, explosion and fire at Exxon's Baton Rouge refinery. This refinery has already resumed partial operation.
- Refined product pipeline breaks in Virginia (jet fuel) and New York Harbor (#2 fuel oil).
- A Barge spill (gasoline) in the Monongahela River outside Pittsburgh, Pennsylvania.

Many of the impacts we are witnessing are symptomatic of a system that is operating near its maximum sustainable capacity. While it provides the most efficient way to deliver energy to the end user at the lowest cost, there is limited flexibility to cope with extraordinary and severe stress on the system. The energy network has demonstrated in the past a remarkable resiliency to respond to routine difficulties such as unusually high demand in one region due to severe weather or refining and pipeline disruptions, such as the Baton Rouge refinery fire. However, with the nations refineries, pipelines, and electric utilities operating at near maximum sustainable capacity there appears to be less and less flexibility to respond to the extraordinary set of circumstances such as we experienced at the end of December. This change in the domestic energy infrastructure and the reduction in reserve operating capacities over the past several years are critical issues that the Department is currently addressing in its comprehensive National Energy Strategy.

In summary, the circumstances driving our domestic energy market during this two week period in December were extraordinary. The severity of the weather in which December 1989 was one of the coldest in recorded U.S. history. Twenty eight cities reported the lowest mean temperatures ever recorded. This unprecedented cold snap and its reach through multiple regions of the country were not, and could not have been, predicted. It was the sudden and rapid increase in demand resulting from the cold (middle distillate demand increased by over 1 million barrels a day) that led to the tight supply of heating oil and propane. In response to this increased demand, there is evidence that additional supplies of product are moving into the affected regions, not only making more product available, but also exerting downward pressure on the higher prices we saw at the end of December, You have asked about the authorities available to respond to circumstances such as were experienced in the second half of December and early January. I have included, as an attachment to this statement, an enumeration of the main energy emergency authorities available to the Department. I also am providing a copy of a 1982 legal memorandum prepared by the Department of Justice describing the legal authorities pertaining to a petroleum supply disruption. There have been a few changes in the laws described in this memorandum, yet it remains a generally sound analysis of the available authorities.

In your letter of invitation you inquired about regional reserves. We are assessing the need for regional petroleum product reserves as part of the National Energy Strategy. Establishing a regional product reserve is essentially the same as taking out an insurance policy. There are costs associated with it, and at some point the cost of carrying the insurance exceeds the benefits derived from it.

In assessing the benefits and costs of establishing and maintaining regional reserves the drawbacks as well as the benefits need to be considered. The ability of regional product reserves to offset cost price hikes, and transportation and distribution problems depends upon many variables, including the frequency of the need to draw upon the reserves and the need to periodically rotate product to prevent its deterioration. Consideration also must be given to the costs associated with the construction of the storage facilities for these reserves, as well as the environmental impacts and siting problems they would present. There are also questions of which products to store and where they should be stored. It should be noted that nothing in the recent history of the propane market would have indicated any requirement to establish and maintain a regional reserve for this product.

Your have also asked about mandating minimum inventory levels. Establishing a minimum inventory level at the beginning of the heating season is an extremely complex issue. The Department's experience in the past with mandating this kind of effort proved to be counter productive. Mandating minimum pre-season inventories of heating oil when refiners are operating at near capacity on a year round basis could cause tight supplies in other refined products, such as gasoline, as refiners alter their refinery yields to satisfy the inventory requirement. Changing demand patterns in the heating oil market coupled with changes in the operating practices of refiners, wholesalers and retailers have significantly altered the inventory behavior of the industry. Consequently, a simplistic reliance on historical levels of inventory would not present an accurate picture of current supply requirements. Additionally, there was no indication in any of the preseason weather forecasts that would have indicated that additional inventories of middle distillate were required for the 1989-90 heating season.

Mr. Chairman, as I indicated at the beginning of my statement we at DOE are concerned and sensitive to the hardships that the sharp rise in energy prices caused for people with limited or fixed incomes. In light of the extraordinary events of December, DOE is conducting a survey of all state energy offices to determine the current status of the funds available to the Low Income Home Energy Assistance Program (LIHEAP). In FY 1990 the Federal Government is spend $1.393 billion on this program. We will provide the information we develop from this survey to the Department of Health and Human Services which has manages this program, and we will consult with that agency on any recommendation for additional funding for this important program.

In closing, Mr. Chairman, I would like to point out that it is the Department of Energy's view , based on its experience over the last two decades, that the complex web of energy producers, transporters, distributors and local suppliers, provide the best and most efficient means for supplying consumers energy needs. Reliance on markets to correct short term supply aberrations is not an ideological imperative, it is simply good public policy

Thank You Mr. Chairman; Dr. Merklein and I will be pleased to answer any of your questions.

ATTACHMENT TO

STATEMENTS OF

JOHN J. EASTON
ASSISTANT SECRETARY FOR
INTERNATIONAL AFFAIRS AND ENERGY EMERGENCIES

and

HELMUT A. MERKLEIN
ADMINISTRATOR
ENERGY INFORMATION AGENCY

U. S. DEPARTMENT OF ENERGY

BEFORE THE
SENATE GOVERNMENTAL AFFAIRS COMMITTEE

JANUARY 16, 1990

EIA
Energy Information Administrat

Preliminary Assessment of Heating Fuel Markets

In response to concern over reports of fuel oil and propane shortages and escalating prices, and as a follow-up to an earlier hearing before the House Subcommittee on Energy and Power, the Energy Information Administration has agreed to do two analyses. A short-term analysis dealing essentially with prices and margins that are available either from public sources or from EIA'S own data bank will be completed and results will be released before the end of January. It is the purpose of this study to provide quick information concerning the dramatic price increases of heating fuels in late December. As always, there is a trade-off between speed and accuracy, and it is speed that dictates the preparation of the short-term analysis. Analysts who plan to use this study should not expect definitive answers to flow from it.

Using EIA'S own data in conjunction with credible information from non-Government sources, EIA will also do a long-term analysis to describe the December pricing phenomenon of heating fuels. Much of the information EIA collects is assembled in monthly cycles. As general rule, respondents are given 4 weeks to close out their books and forward their data to EIA, where an additional 4 weeks are required to edit, verify, assemble and print this information. Thus, on a monthly collection system, data availability usually lags by about two months.

EIA's long-term analysis is expected to be scrutinized by local and federal law enforcement agencies. This being the case, it is imperative that all data, including profit data, be considered. As a result, we will hold back publication of the long-term in-depth study until after the first Quarter of 1990, when 10-Q Forms have been filed with the Securities and Exchange Commission. I realize that this will appear to many to be an inordinate delay. That is why the short-term study, designed to meet the immediate concerns of the public, is being prepared, while the long-term analysis will be done with the deliberativeness and thoroughness that the occasion demands.

In addition to these analyses, the Department of Energy has conducted an interim assessment of the heating fuel situation based on preliminary information. Routine data collected by The Energy Information Administration were supplemented by three emergency surveys (two in December and one in January) of heating fuel producers and distributors, as well as selected price data provided by the Bureau of Labor Statistics, State Energy Offices, and leading trade journals/news services. The results of this interim study are as follows:

Prices

Wholesale and retail No. 2 distillate prices increased dramatically over the period from early August through the end of December, with the bulk of those increases occurring in December.

- At the beginning of the 1989/1990 heating season (October 1989), residential heating oil prices exceeded year-earlier levels by about 10 cents per gallon. This is roughly equivalent to the 12 cent-per-gallon price increase of crude oil over the period October 1988 to October 1989.

- Starting into the 1989/90 heating season, residential heating oil prices rose moderately until Mid-December of 1989. At that point they shot up dramatically, especially in the New England, Mid-Atlantic and Midwest Regions (PADDS IA and IB, and II), reaching a level of 146.5 cents/gallon in New England by January 2, 1990.

- The New York Harbor spot price of No. 2 distillate fuel oil (a wholesale market) exhibited a price pattern similar to that of PADD I: moderate price increases to about 80 cents per gallon in Mid-December followed by a sudden increase to 115 cents per gallon on December 27. By January 9, 1990, the New York Harbor spot price had receded to 75 cents per gallon. This is roughly in line with last January's wholesale markets, adjusted for increases in crude oil prices.

Propane. As a percent of pre-season levels, the largest heating fuel price increases were in propane, most of which occurred during December.

- At the outset of the 1989/90 heating season, propane prices at the national level were $0.02 higher at wholesale and $0.09 lower to retail customers than last year. Prior to December, wholesale prices remained stable, while retail prices eroded by about $0.03 per gallon (to $0.57).

- Residential propane prices responded sharply to the severe cold weather in December. By January 2, residential prices in New York had climbed $0.33 per gallon in less than three weeks to $1.40. In the Midwest, price increases were similar. For example, in Ohio, comparable propane prices rose $0.30 per gallon in the second half of December.

- At major terminals in Texas and Kansas the price of propane increased about 207 percent and 243 percent, respectively, in the month of December. The increases in wholesale propane prices were not as concentrated in the latter half but occurred more evenly throughout the month.

Underlying Factors

Demand

- Of the numerous factors underlying these sharp price increases, by far the most important was demand. **Distillate demand** increased almost 1.0 million barrels per day (MMBD), or 31 percent, to 4.1 MMBD at the U.S. level in December --the largest one-month increase in at least a decade, most of which occurred on the East Coast.
    - This increase was more than double that seen in December 1983, when prices also rose sharply in response to a sudden cold snap.
    - The increase was almost three times larger than the more typical rise during December 1988 which was approximately 375 thousand barrels per day (MBD).
- Strong demand for **propane** in 1989 re-emerged in October and November, after lapsing over the summer, when a wet harvesting season generated increased agricultural demand, at the expense of stocks at the end of November. This was followed by the extreme cold weather of December when demand for propane appears to have reached its highest level in years.
- The **enormous increase** in heating fuel demand was generated by the unexpected, widespread cold wave, which blanketed most of the U.S. in December. On a heating degree basis, December was 27 percent colder than normal nationally (and 29 percent colder than last December), and 31 percent colder than normal on the East Coast (the coldest December in at least 60 years).

Supply

- Supply factors, to a lesser extent, also contributed to the increases in heating fuel prices. U.S. primary **distillate inventories** at the end of October (the outset of the heating season) stood at approximately 121 million barrels (MMB), 7 MMB lower than last year's level, but **the same level as 2 years ago.**
- Similarly, distillate stocks on the East Coast at the end of October were 5 MMB lower than last year's level of 57 MMB, **but only 1 MMB lower than the year before**.
- Several factors contributed to this year's lower stock levels at the beginning of the heating season relative to last year:

  - Generally, distillate stock levels at the beginning of the heating season have trended downward over the past decade. The doubling of heating oil prices and high interest rates characterizing the late seventies and early eighties dramatically increased inventory carrying costs. These costs may have permanently altered refiner and distributor (jobbers and retailers) inventory behavior by acting as disincentives to preseason stock buildup.

  - Even though beginning-of-season distillate inventories have trended down over the years, end-of-season inventories (end of April) have been remarkably stable over the last 7 years. They fluctuated from a high of 103 million barrels in April of 1983 to 95 million barrels in April of 1988. This compares to a minimum operating level, as determined by the National Petroleum Council, of 85 million barrels.

  - Forecasts as late as the end of October indicated warmer than normal weather was expected for November and December 1989. This, coupled with the fall supply/demand trends, tended to confirm the widespread industry assessment that distillate stocks were adequate to meet expected winter demand.

  - Since inventories seemed adequate as late as Thanksgiving, and distillate production reached 3.4 MMBD in December 1989 (the highest level since at least 1982, despite numerous refinery problems that month), the bulk of the price increases can only be explained by the monumental 31 percent increase in demand in December of 1989.

o Prior to the heating season in late September, primary **propane stocks** were 60.5 MMB. While this was about 4 percent below stock levels at the same time last year, it was 3.7 MMB **more** than in 1987 and 3.3 MMB **more** than the level in 1985. In less than three months, this national inventory dropped to an estimated range of 37 to 45 MMB--the lowest point in 20 years (according to industry sources.) The December drawdown alone was estimated at between 13 and 16 MMB. This was only the fourth time since 1969 that December's drop in propane stocks was greater than 9 MMB.

Refinery and Distribution Problems

o The increased demand on primary supplies of **distillate heating oil** brought on by the unanticipated early cold weather resulted in short-term transportation bottlenecks. No **consistent** terminal outages could be confirmed. However, particularly in New England, some terminals ran out for a day or two until the next shipment arrived. Typically, suppliers limited sales to contract customers prorated to "normal" levels, thereby increasing the demand on spot markets. This, in turn, put additional upward pressure on spot heating oil prices.

- During the last two weeks of December, a number of refineries were completely shut down or had reduced operations primarily due to the cold weather and/or fires and explosions. At least thirteen refineries, whose capacity totals about 3.0 MMBD, were affected. Distillate production at these refineries was reduced to 301 MBD for the week ending December 29 from 608 MBD the previous week.

- In contrast to the distillate market, where prices escalated but physical shortages failed to materialize, outages did occur in the **propane market**. By December 21, many propane suppliers were experiencing outages, especially in the Northeast, the upper Midwest, and as far South as Kansas and Tennessee. Unlike No. 2 distillate, **propane supplies** were being drained faster than they could be replenished. December product was reported to be unavailable on spot markets, while virtually all suppliers began to limit sales to contract customers at minimum allowable volumes. To assure continued supply for residential accounts, it was reported that "lower priority" customers in commercial or industrial categories were cut off selectively.

Prospects for Remainder of 1989/90 Heating Season

Inventories

- **Distillate**. With the return to near normal temperatures across most of the eastern half of the country, the distribution system is recovering. As of the beginning of the year, product was going into pipelines at maximum rates. The transportation problems which previously delayed the replenishment of storage at the consuming end of the pipelines and barge deliveries are abating with warmer weather. In fact, distillate stocks grew the first week of January by 2.5 MMB nationally, and by 1 MMB in PADD I (to 109 and 37 MMB, respectively).

- Production is expected to regain much of the volume lost in the last two weeks of December. Of the 13 refineries adversely affected by emergency shut downs and operational problems, all are expected to be back to full capacity by the end of January, with the possible exception of Exxon's Baton Rouge plant, which is expected to be operating at a capacity of at least 50%.

- On January 2, there was a fuel oil spill of 10 to 15 MB from Exxon's product pipeline in the waters between Staten Island and the New Jersey coastline. This resulted in a one-day shutdown of barge traffic in the Arthur Kill Waterway, adversely affecting operations of several marine bulk terminals. By January 4, restricted barge movements were allowed. Although shipments have been impeded, there does not appear to be any significant impact on heating oil prices or product availability to the Northeast.

- When heating oil spot prices peaked in the U. S. at $1.15 per gallon on December 27, they were only about $0.76 per gallon in Rotterdam, which historically has served as an important supplemental supply source to the East Coast. As a general rule, a $0.05 per gallon increase will start movement of supplies to the higher-priced location. With the prevailing December/January spot price differential, substantially increased imports can be expected for January.

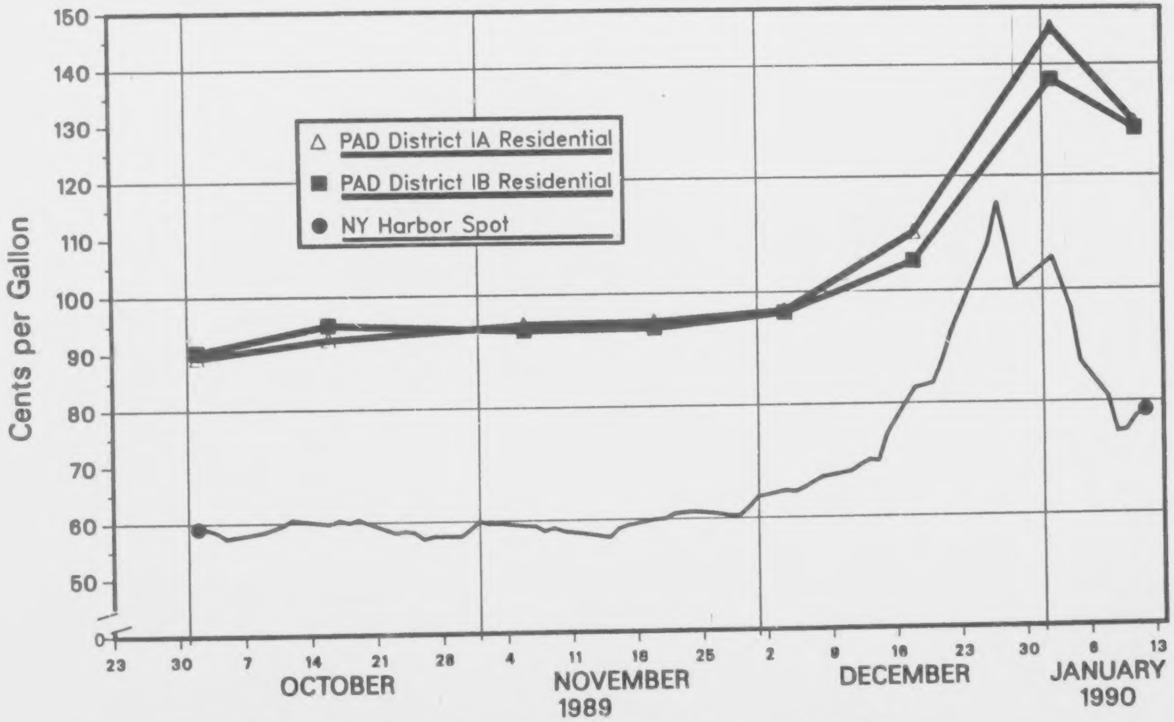
- Propane. Even with the prospect of milder weather, many propane suppliers are not overly confident about the sustainability of a recovery under anything less than ideal conditions. Depletion of inventories, at this point, is such that several weeks of good weather will be required to replenish the supply system. The recent and expected arrival in Northeast ports of several shipments of imported propane will help alleviate the general shortage, but time will be required for these to work their way by ground transportation to the most critical areas.

Prices

- Although refiners' wholesale **distillate prices** are expected to follow the price decline in the spot market, lags in the reduction of retail prices can be expected. Nonrefiner distributors that were forced to purchase inventory at the high prices reported in December may attempt to recoup these costs as long as residential demand persists. Nevertheless, on an inflation adjusted basis, U.S. residential prices in December were still $0.68 below (38 percent less than) the all-time high which occurred in March 1981. Furthermore, **residential prices in New England, the Mid-Atlantic States, and the Midwest have dropped** $0.16, $0.07, and $0.03 per gallon, respectively, since the beginning of January.

- **Propane** is expected to follow the same pattern as distillate. In the first week of January, terminal prices fell from $0.14 to $0.17 per gallon in the middle of the country, closest to the source of production. Meanwhile, a decline in terminal prices in the Northeast and upper Midwest and, in turn, prices to residential customers, may follow suit as higher-priced inventory is cleared out of the distribution system.

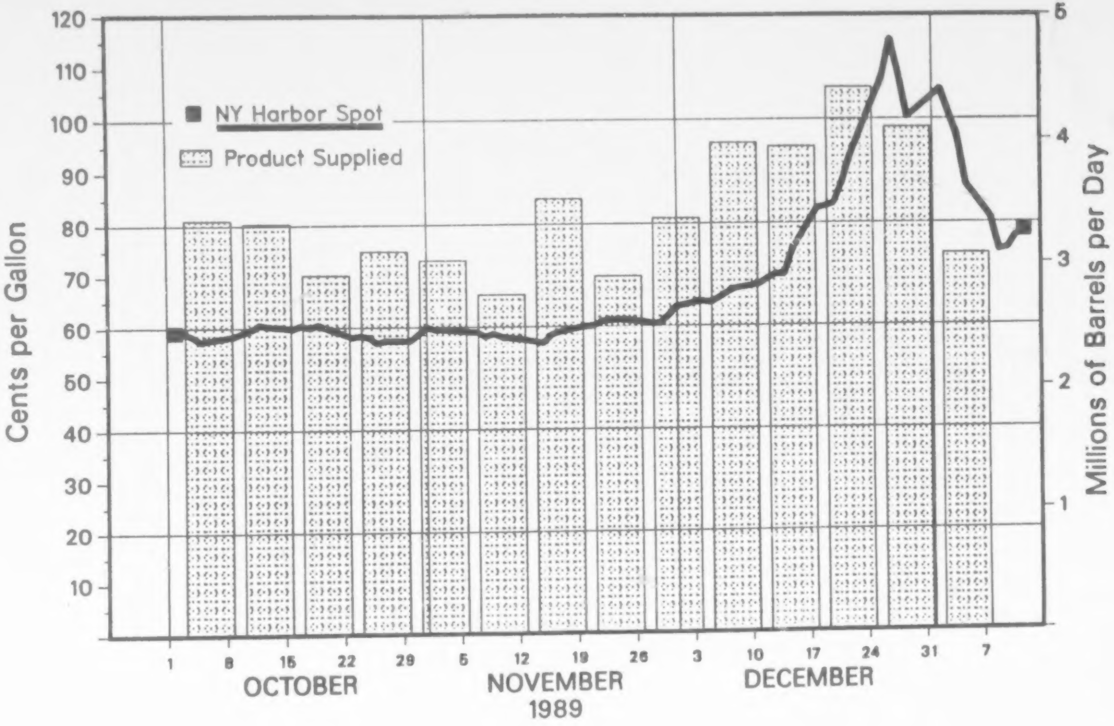
RESIDENTIAL AND SPOT NO. 2 FUEL OIL PRICES, Fourth Quarter, 1989



Note: PAD District IA includes Connecticut, Maine, Rhode Island, and Vermont.
PAD District IB includes Delaware, New Jersey, New York, and Pennsylvania.

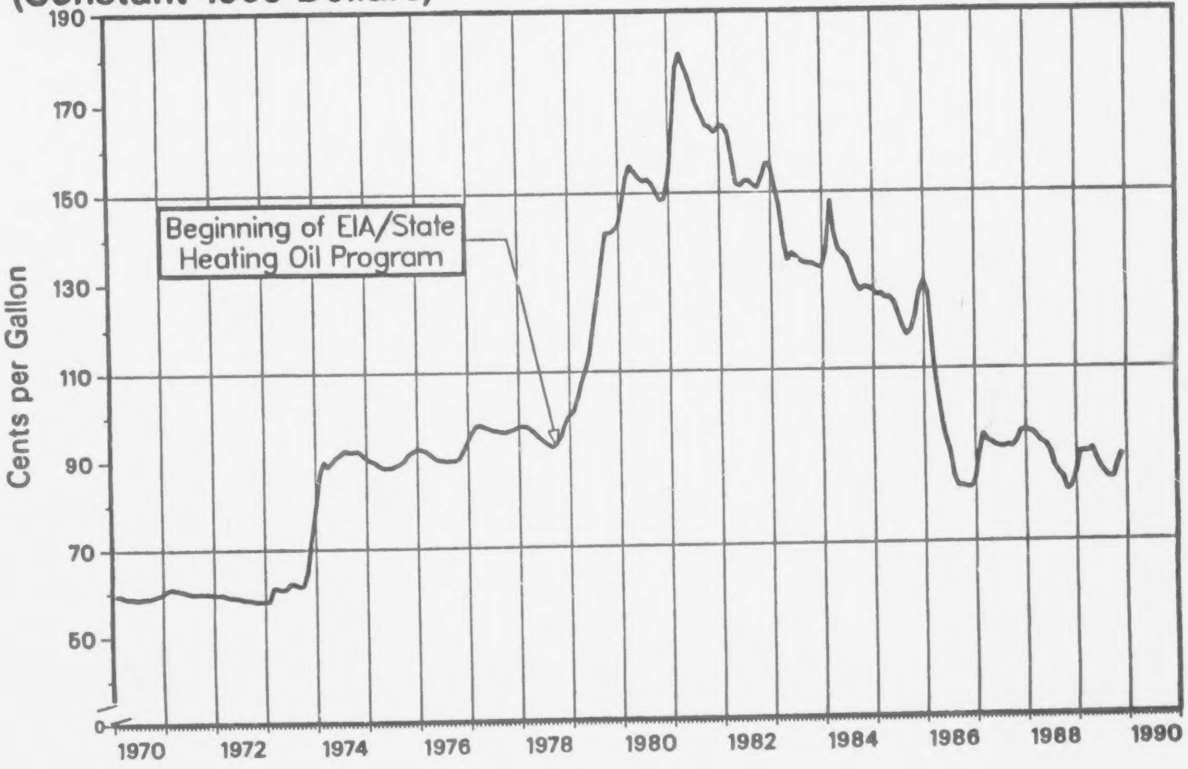
Source: EIA/State Heating Oil Program and Reuters.

SPOT NO. 2 FUEL OIL PRICES AND PRODUCT SUPPLIED, Fourth Quarter, 1989



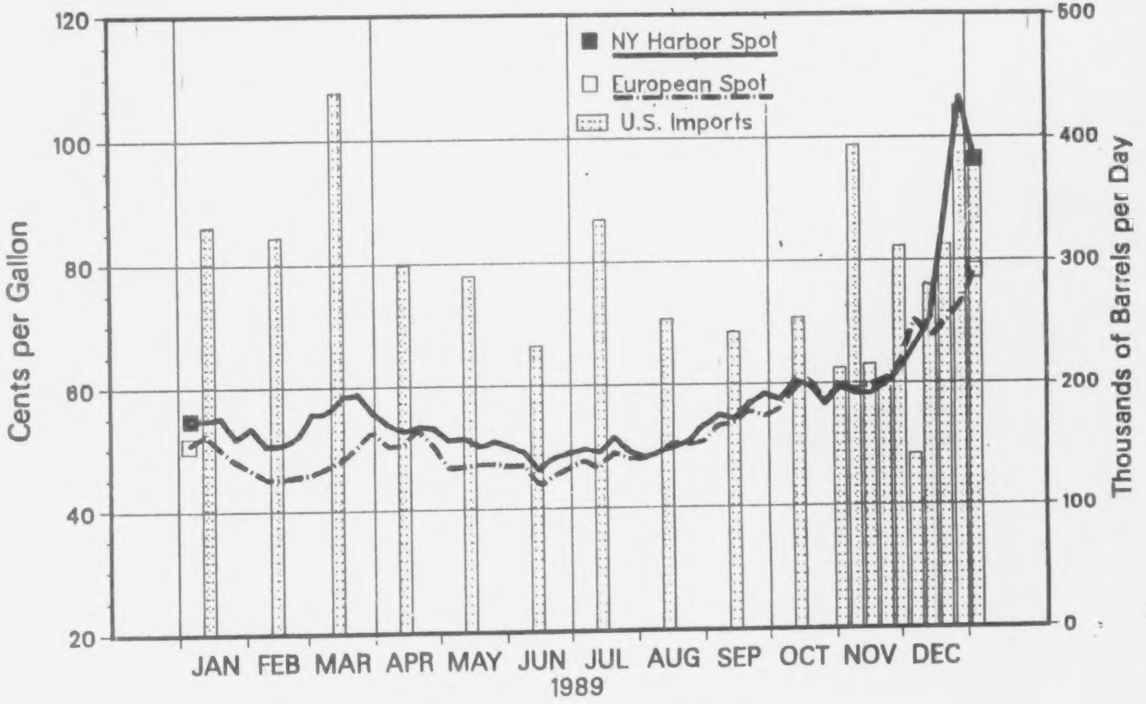
Source: EIA Weekly Petroluem Status Report and Reuters.

National Average Residential No. 2 Fuel Oil Prices, 1970 to Present (Constant 1989 Dollars)

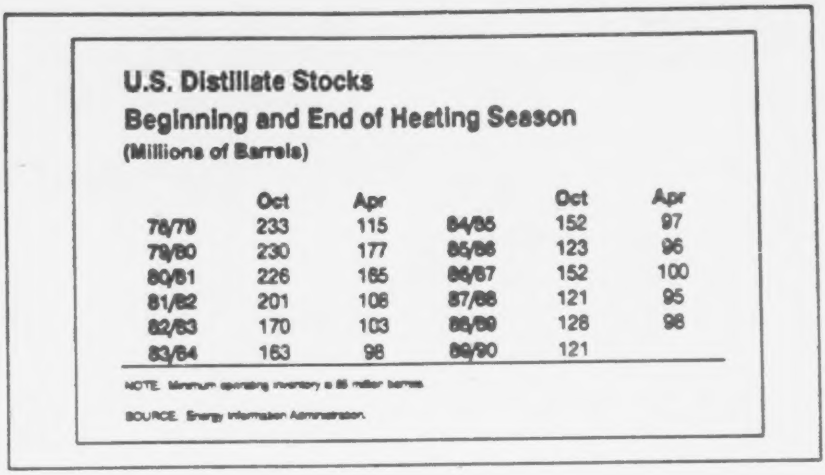


Source: Bureau of Labor Statistics.

Spot No. 2 Fuel Oil Prices and U.S. Imports
1989



Source: EIA Weekly Petroluem Status Report and Oil Buyers Guide

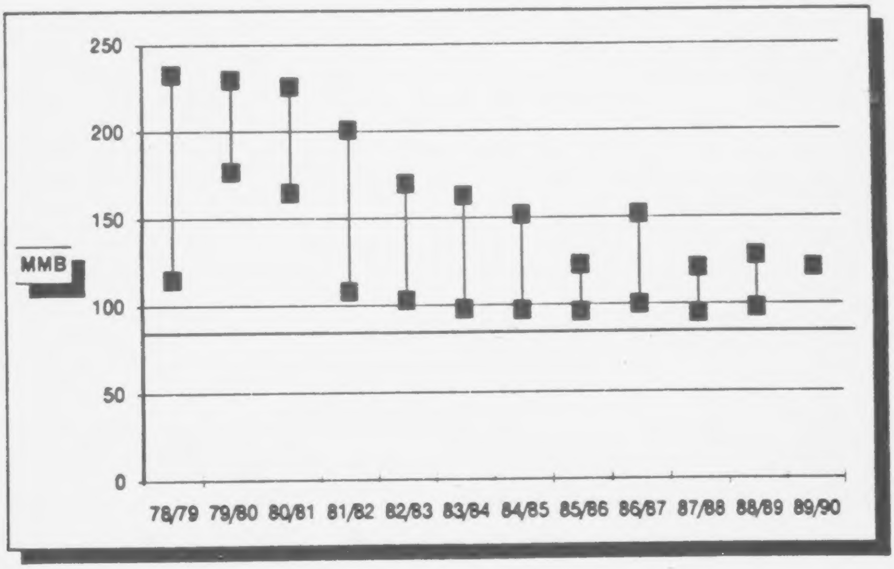


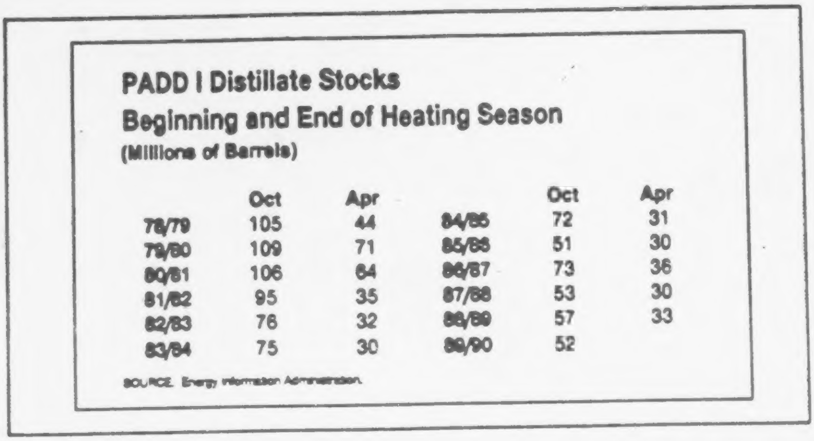
U.S. Distillate Stocks
Beginning and End of Heating Season
(Millions of Barrels)

	Oct	Apr		Oct	Apr
78/79	233	115	84/85	152	97
79/80	230	177	85/86	123	96
80/81	226	165	86/87	152	100
81/82	201	108	87/88	121	95
82/83	170	103	88/89	126	98
83/84	163	98	89/90	121	

NOTE: Minimum operating inventory is 85 million barrels.

SOURCE: Energy Information Administration.



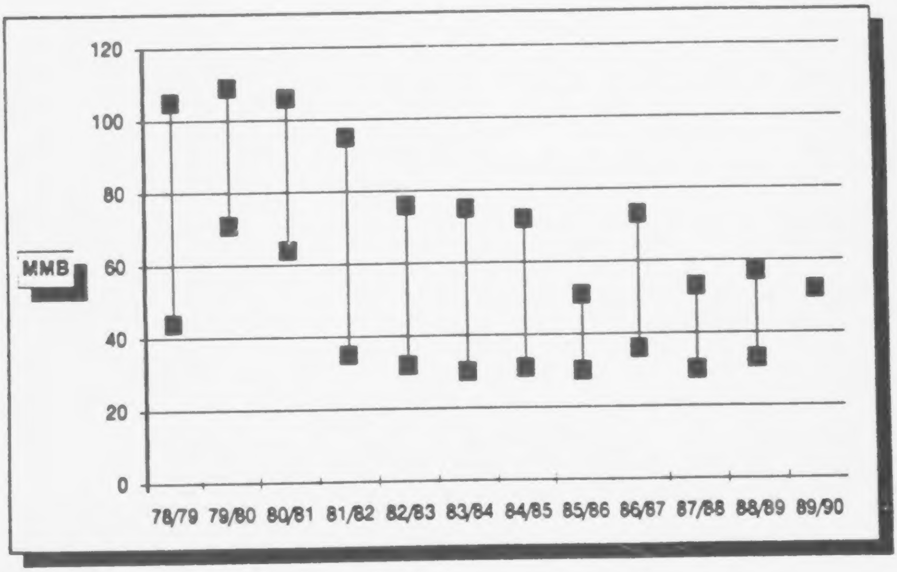


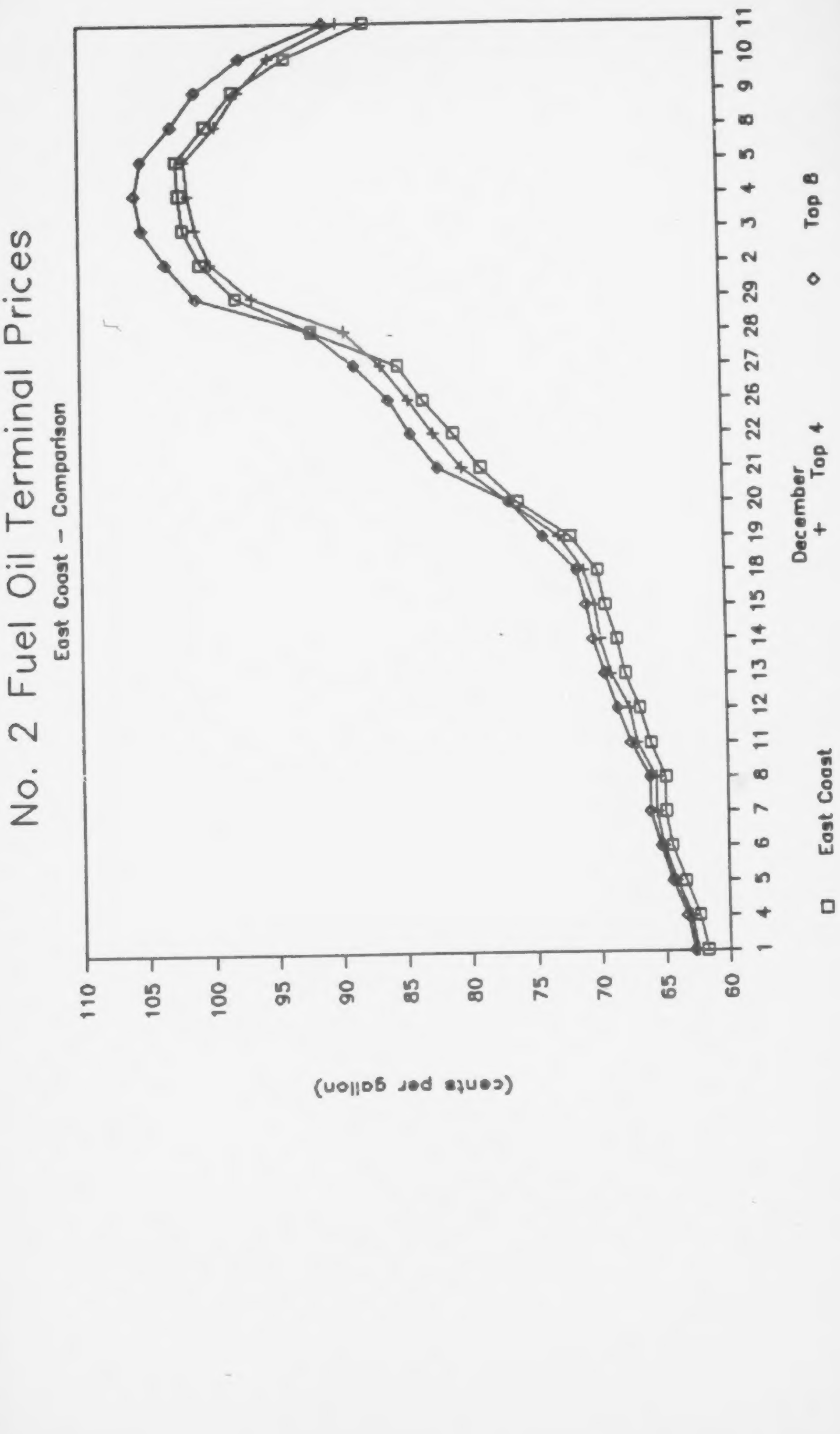
PADD I Distillate Stocks
Beginning and End of Heating Season

(Millions of Barrels)

	Oct	Apr		Oct	Apr
78/79	105	44	84/85	72	31
79/80	109	71	85/86	51	30
80/81	106	64	86/87	73	36
81/82	95	35	87/88	53	30
82/83	76	32	88/89	57	33
83/84	75	30	89/90	52	

SOURCE: Energy Information Administration.



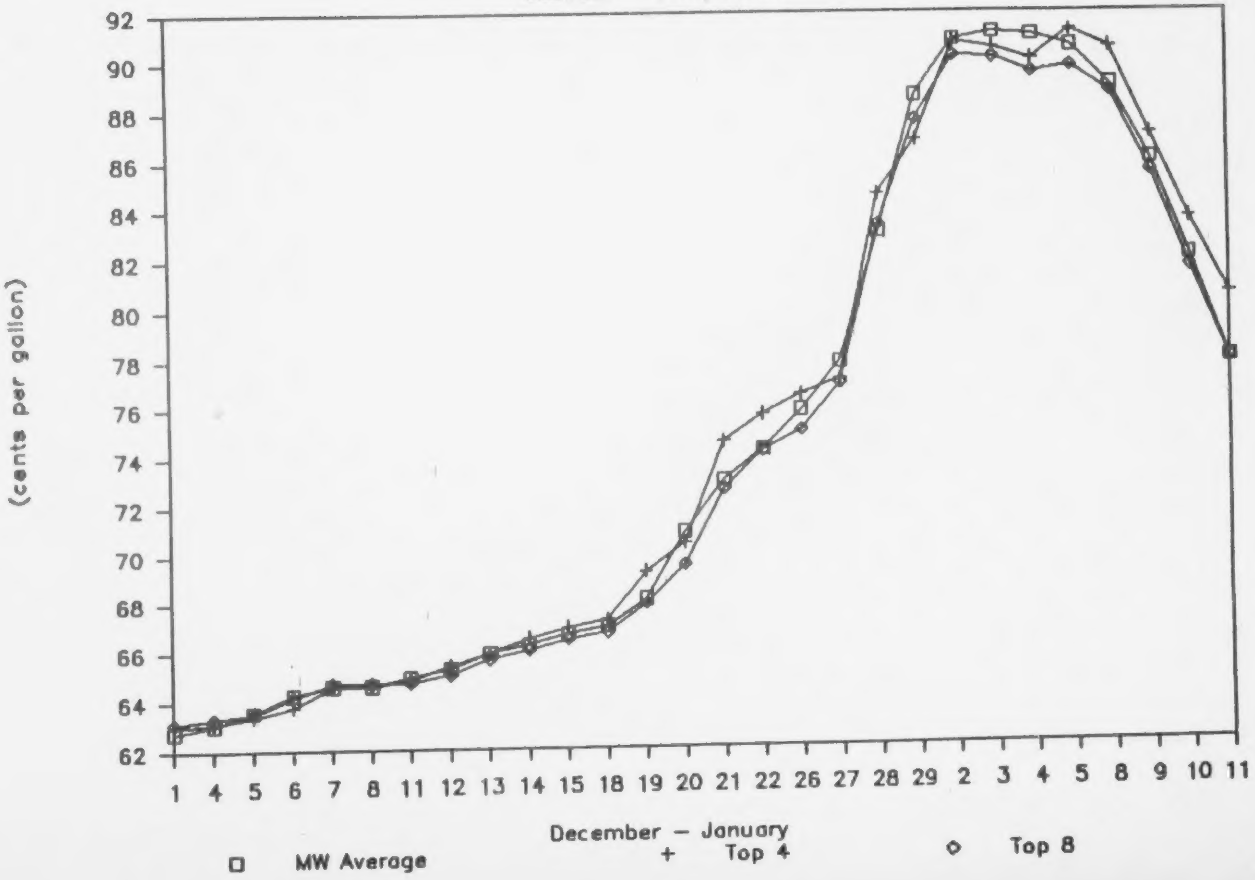


No. 2 Fuel Oil Terminal Prices

East Coast – Comparison

No. 2 Fuel Oil Prices

Midwest – Comparison



Real U.S. Residential Heating Oil Prices

Cents per Gallon, 1989 Dollars

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
82	164.9	163.5	158.5	151.8	151.4	152.6	152.6	151.6	150.9	153.4	156.5	156.1
83	151.3	147.0	139.3	134.5	136.2	135.4	134.4	133.9	133.8	133.7	133.1	132.8
84	136.5	147.8	140.0	136.7	135.9	134.7	132.1	129.2	127.7	128.5	128.3	127.7
85	126.7	127.0	126.0	126.1	125.1	122.5	119.7	117.7	118.8	121.9	127.2	129.6
86	127.4	114.7	106.8	99.9	94.4	91.3	85.1	82.6	82.8	82.3	82.3	84.1
87	91.0	94.6	93.2	92.7	92.0	91.8	91.7	92.2	91.8	92.9	95.3	95.6
88	95.3	94.9	93.8	92.7	92.2	90.6	87.1	85.6	84.6	81.4	82.2	85.1
89	90.4	90.6	90.4	91.2	88.9	86.5	85.4	84.3	84.3	87.5	89.9	E112.8

E=Estimate

Source: Energy Information Administration calculations based on Bureau of Labor Statistics data.

Nominal U.S. Residential Heating Oil Prices

Cents per Gallon

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
82	125.4	124.8	120.8	116.2	117.1	119.4	120.0	119.5	119.1	121.4	123.7	122.9
83	119.4	116.0	110.1	107.0	108.9	108.7	108.3	108.3	108.7	108.9	108.6	108.5
84	112.2	122.0	115.8	113.7	113.4	112.7	110.9	108.8	108.1	109.1	108.9	108.5
85	107.8	108.5	108.1	108.7	108.2	106.3	104.0	102.5	103.8	106.8	111.9	114.3
86	112.6	101.1	93.7	87.5	83.0	80.6	75.1	72.6	73.6	73.3	73.3	75.0
87	81.7	85.1	84.3	84.3	83.9	84.1	84.2	85.0	85.2	86.3	88.8	88.9
88	89.0	88.8	88.1	87.6	87.4	86.2	83.2	82.2	81.7	79.0	79.8	82.6
89	88.3	88.8	89.1	90.4	88.7	86.7	85.7	84.6	85.0	88.7	91.3	E115.0

E=Estimate

Source: Bureau of Labor Statistics.

Residential Heating Oil Prices

Cents per Gallon

	PADD District		
	IA	IB	II
10/2	89.3	90.3	82.5
10/16	92.4	95.0	83.5
11/6	94.7	93.7	85.1
11/20	95.0	93.9	86.6
12/4	96.7	96.4	87.4
12/18	110.2	105.2	91.8
1/2	146.5	137.3	113.4
1/11	129.5	128.4	103.8

Source: EIA/State Heating Oil Program

New York Harbor Spot No. 2 Distillate Prices, 1989-90

Cents per Gallon

	Aug	Sep	Oct	Nov	Dec	Jan
1	48.0	53.3		59.9	63.7	
2	48.6		58.9	59.4		105.6
3	48.2		58.9	59.5		101.2
4	48.3		58.3		64.8	96.7
5		53.9	57.2		64.5	87.4
6		55.6	57.5	59.0	65.3	
7	47.5	54.8		58.9	66.3	
8	47.0	56.1		58.0	67.2	80.9
9	48.2		58.3	58.6		74.6
10	48.8		59.0	57.9		74.9
11	48.7	55.3	59.5		68.0	77.3
12		54.4	60.5		69.1	78.4
13		54.4	60.2	57.3	70.0	
14	48.6	54.0		57.0	69.9	
15	49.4	55.0		56.7	74.9	
16	50.0		59.7	58.4		
17	49.9		60.4	59.0		
18	49.9	54.7	59.9		82.9	
19		54.2	60.5		83.2	
20		55.6	59.8	59.9	83.7	
21	51.0	56.7		60.0	87.5	
22	50.8	56.1		60.9	92.8	
23	51.0		58.0			
24	51.0		58.3	61.2		
25	50.8	56.8	58.0			
26		56.8	56.8		108.0	
27		58.1	57.3	60.7	115.2	
28	50.9	58.1		60.4	108.4	
29	51.2	58.8		60.4	100.3	
30	52.4		57.2	61.9		
31	53.1		58.5			

SOURCE: Reuters

U.S. Distillate Stocks

(Thousands of Barrels)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
82	164,380	147,446	128,305	107,858	113,844	123,888	148,150	158,858	161,189	170,148	185,580	178,582
83	167,855	148,221	118,122	103,132	108,804	113,723	130,855	142,406	153,898	162,551	161,211	140,263
84	119,317	132,242	109,572	97,890	98,144	112,849	124,421	133,317	142,843	152,236	160,870	161,072
85	142,384	121,439	99,290	96,845	104,432	109,888	115,883	113,755	117,367	123,417	138,719	143,873
86	138,490	112,402	98,811	95,907	98,857	107,895	118,905	137,737	152,403	151,817	158,263	155,097
87	141,342	123,730	109,332	100,338	101,298	104,391	114,802	124,735	128,782	120,974	128,004	134,485
88	128,098	110,301	89,843	94,872	104,879	110,418	119,855	125,889	131,451	128,248	128,805	123,517
89	120,290	107,549	98,025	98,378	99,298	99,419	114,874	118,057	122,239	121,446	121,900	108,700

Source: Energy Information Administration

U.S. Distillate Refinery Production

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
82	2,591	2,427	2,288	2,358	2,618	2,729	2,734	2,507	2,658	2,838	2,860	2,855	2,606
83	2,321	2,135	1,993	2,171	2,444	2,548	2,804	2,615	2,739	2,631	2,880	2,522	2,454
84	2,590	2,866	2,477	2,341	2,623	2,879	2,718	2,660	2,705	2,890	2,825	2,796	2,661
85	2,630	2,502	2,265	2,488	2,684	2,645	2,644	2,591	2,592	2,900	3,101	3,174	2,685
86	2,697	2,561	2,642	2,786	2,857	2,728	2,709	2,821	2,804	2,716	2,915	2,941	2,795
87	2,758	2,554	2,420	2,551	2,561	2,687	2,699	2,704	2,747	2,779	3,034	3,240	2,726
88	3,006	2,666	2,706	2,965	2,935	2,891	2,783	2,847	2,777	2,826	2,908	3,067	2,857
89	2,973	2,798	2,714	2,788	2,748	2,806	2,846	2,905	2,950	2,906	3,075	3,359	2,906

Source: Energy Information Administration

U.S. Distillate Imports

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
82	97	132	48	59	74	102	125	80	81	91	145	109	93
83	68	59	42	73	147	179	267	301	259	280	203	221	174
84	299	454	115	220	253	256	199	259	291	421	316	190	272
85	272	143	156	253	197	152	95	81	222	262	280	287	200
86	325	169	217	147	149	169	313	370	262	243	254	339	247
87	222	253	297	192	203	265	381	222	222	237	187	378	255
88	424	363	247	210	253	222	222	279	307	336	327	409	302
89	331	322	439	299	290	233	335	254	243	254	275	291	297

Source: Energy Information Administration

U.S. Distillate Product Supplied

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
82	3,484	3,085	2,945	2,978	2,444	2,452	2,068	2,218	2,507	2,581	2,475	2,855	2,671
83	2,797	2,780	2,047	2,697	2,364	2,524	2,270	2,495	2,575	2,611	2,874	3,365	2,690
84	3,525	2,834	3,259	2,826	2,814	2,593	2,504	2,559	2,654	2,765	2,827	2,865	2,845
85	3,465	3,330	3,093	2,798	2,807	2,594	2,436	2,636	2,575	2,901	2,747	3,254	2,868
86	3,330	3,416	3,168	2,804	2,762	2,544	2,592	2,621	2,540	2,912	2,677	3,329	2,914
87	3,310	3,345	3,116	2,991	2,884	2,790	2,713	2,553	2,838	3,151	2,932	3,318	2,976
88	3,558	3,557	3,539	2,864	2,795	2,854	2,840	2,873	2,021	3,218	3,183	3,560	3,122
89	3,296	3,411	3,429	2,973	2,957	2,998	2,592	2,970	2,906	3,096	3,137	4,108	3,156

Source: Energy Information Administration

PADD I Distillate Stocks

(Thousands of Barrels)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
82	68,331	80,311	44,692	34,962	39,142	44,209	57,395	63,859	67,950	75,728	86,691	80,588
83	71,091	55,456	37,973	31,779	36,935	41,048	50,869	61,661	67,549	74,558	70,697	57,710
84	43,340	54,446	37,307	29,835	32,687	40,010	45,261	49,095	57,506	71,850	74,835	72,909
85	56,306	43,386	32,773	31,255	33,466	34,275	38,791	40,995	47,077	52,372	61,425	58,586
86	56,272	37,981	36,134	30,069	30,698	35,244	46,338	59,382	68,861	73,325	74,101	75,344
87	65,299	48,754	41,503	36,131	34,565	37,040	44,824	50,506	52,438	53,360	52.123	53,754
88	48,114	44,423	33,042	30,021	34,903	37,440	44,704	52,322	57,030	56,708	54,575	49,223
89	46,323	37,223	33,343	33,212	32,928	35,558	44,534	48,416	50,163	51,741	51,800	35,700

SOURCE: Energy Information Administration.

PADD I Distillate Imports

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
82	91	111	37	50	66	89	111	72	56	68	125	105	82
83	59	38	34	65	117	150	234	275	232	250	177	204	153
84	277	447	106	174	230	234	171	236	271	401	301	177	252
85	264	131	125	226	162	132	79	67	184	241	253	258	177
86	308	144	198	125	121	151	300	354	235	210	233	318	225
87	200	237	260	172	180	244	343	199	200	223	175	352	232
88	414	372	232	198	227	201	201	267	283	324	315	397	286
89	316	310	414	291	272	225	310	225	218	238	NA	NA	NA

SOURCE: Energy Information Administration.

PADD I Distillate Product Supplied

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
82	1,744	1,326	1,327	1,093	725	725	542	622	766	787	794	1,276	976
83	1,319	1,354	1,241	980	722	727	611	737	765	816	1,081	1,507	988
84	1,728	1,124	1,447	1,075	861	717	655	805	734	904	1,112	1,229	1,033
85	1,745	1,580	1,190	977	741	817	638	743	757	920	918	1,464	1,041
86	1,636	1,748	1,212	1,121	878	795	727	814	847	1,011	1,137	1,509	1,120
87	1,605	1,749	1,285	1,110	926	875	835	822	909	1,106	1,237	1,505	1,164
88	1,766	1,719	1,469	1,024	867	920	754	972	972	1,142	1,233	1,869	1,209
89	1,532	1,644	1,479	1,082	983	918	797	976	945	1,093	E1192	E2054	NA

E: Estimated PADD I Product Supplied. Reported numbers not available.
SOURCE: Energy Information Administration.

No. 2 Distillate Margins: PADD IA

Cents per Gallon

		Prices		Margins	
	Crude Oil WTI Spot	Wholesale	Retail Heating Oil	Wholesale	Retail
2-Oct	47.6	60.6	89.3	13.0	28.7
16-Oct	49.1	62.8	92.4	13.7	29.6
6-Nov	47.8	63.1	94.7	15.3	31.6
20-Nov	47.9	61.1	95.0	13.2	33.9
4-Dec	48.2	64.0	96.7	15.8	32.7
18-Dec	52.9	74.1	110.2	21.2	36.1
2-Jan	54.5	113.5	146.5	59.0	33.0
11-Jan	55.1	91.5	129.5	36.4	38.0

SOURCES: WTI (West Texas Intermediate Crude Oil), Reuters;
Heating Oil, Energy Information Administration/State Heating Oil Program;

No. 2 Distillate Margins: PADD IB

Cents per Gallon

		Prices		Margins	
	Crude Oil WTI Spot	Wholesale	Retail Heating Oil	Wholesale	Retail
2-Oct	47.6	59.0	90.3	11.4	31.3
16-Oct	49.1	61.7	92.4	12.6	30.7
6-Nov	47.8	62.1	94.7	14.3	32.6
20-Nov	47.9	60.1	95.0	12.2	34.9
4-Dec	48.2	62.4	96.7	14.2	34.3
18-Dec	52.9	71.6	105.2	18.7	33.6
2-Jan	54.5	107.5	137.3	53.0	29.8
11-Jan	55.1	88.1	128.4	33.0	40.3

SOURCES: WTI (West Texas Intermediate Crude Oil), Reuters;
Heating Oil, Energy Information Administration/State Heating Oil Program;

No. 2 Distillate Margins: PADD II

Cents per Gallon

	Prices			Margins	
	Crude Oil WTI Spot	Wholesale	Retail Heating Oil	Wholesale	Retail
2-Oct	47.6	59.6	82.5	12.0	22.9
16-Oct	49.1	61.5	83.5	12.4	22.0
6-Nov	47.8	62.9	85.1	15.1	22.2
20-Nov	47.9	62.0	86.6	14.1	24.6
4-Dec	48.2	62.8	87.4	14.6	24.6
18-Dec	52.9	67.0	91.8	14.1	24.8
2-Jan	54.5	90.9	113.4	36.4	22.5
11-Jan	55.1	73.3	103.8	18.2	30.5

SOURCES: WTI (West Texas Intermediate Crude Oil), Reuters;

Heating Oil, Energy Information Administration/State Heating Oil Program;

No. 2 Distillate Margins: PADD III

Cents per Gallon

	Prices			Margins	
	Crude Oil WTI Spot	Wholesale	Retail Diesel	Wholesale	Retail
6-Oct	47.4	59.3	102.7	11.9	43.4
20-Oct	47.7	59.8	103.9	12.1	44.1
3-Nov	48.2	59.0	104.7	10.9	45.7
17-Nov	47.5	57.2	105.0	9.7	47.9
1-Dec	48.2	59.4	105.1	11.2	45.7
15-Dec	50.3	66.4	116.5	16.1	50.1
5-Jan	54.9	94.0	130.5	39.1	36.5

Note: Retail diesel includes all taxes, about $0.30 per gallon.

SOURCES: WTI (West Texas Intermediate Crude Oil), Reuters;

Wholesale, Platt's Oilgram Price Report.

Retail Diesel, EIA calculations based on Lundberg Survey data.

U.S. Market Shares
(percent)

	1984	1985	1988	YTD 89
No. 2 Distillate				
Top 4	22	26	26	22
Top 8	37	42	43	39
No. 2 Fuel Oil				
Top 4	26	25	26	29
Top 8	46	47	47	53
No. 2 Diesel				
Top 4	28	33	39	33
Top 8	48	53	56	53

No. 2 Distillate

Top 4 Companies' Market Share
(percent)

	1984	1985	1988	YTD 89
PADD 1A	69	73	62	58
PADD 1B	38	48	39	47
PADD 1C	31	32	33	36
PADD 2	31	31	33	33
PADD 3	22	25	29	27
PADD 4	45	46	43	49
PADD 5	50	55	55	55

Top 8 Companies' Market Share
(percent)

	1984	1985	1988	YTD 89
PADD 1A	88	90	85	86
PADD 1B	63	67	67	76
PADD 1C	55	54	57	60
PADD 2	50	51	54	54
PADD 3	41	43	51	51
PADD 4	74	75	70	75
PADD 5	71	76	76	78

No. 2 Fuel Oil

Top 4 Companies' Market Share
(percent)

	1984	1985	1988	YTD 89
PADD 1A	68	72	61	57
PADD 1B	39	48	42	54
PADD 1C	49	46	48	54
PADD 2	41	41	46	49
PADD 3	47	44	51	50
PADD 4	89	83	93	92
PADD 5	56	61	61	68

Top 8 Companies' Market Share
(percent)

	1984	1985	1988	YTD 89
PADD 1A	88	90	86	87
PADD 1B	65	68	69	79
PADD 1C	74	74	75	77
PADD 2	65	66	71	72
PADD 3	75	70	74	76
PADD 4	99	98	100	100
PADD 5	88	92	86	89

No. 2 Diesel

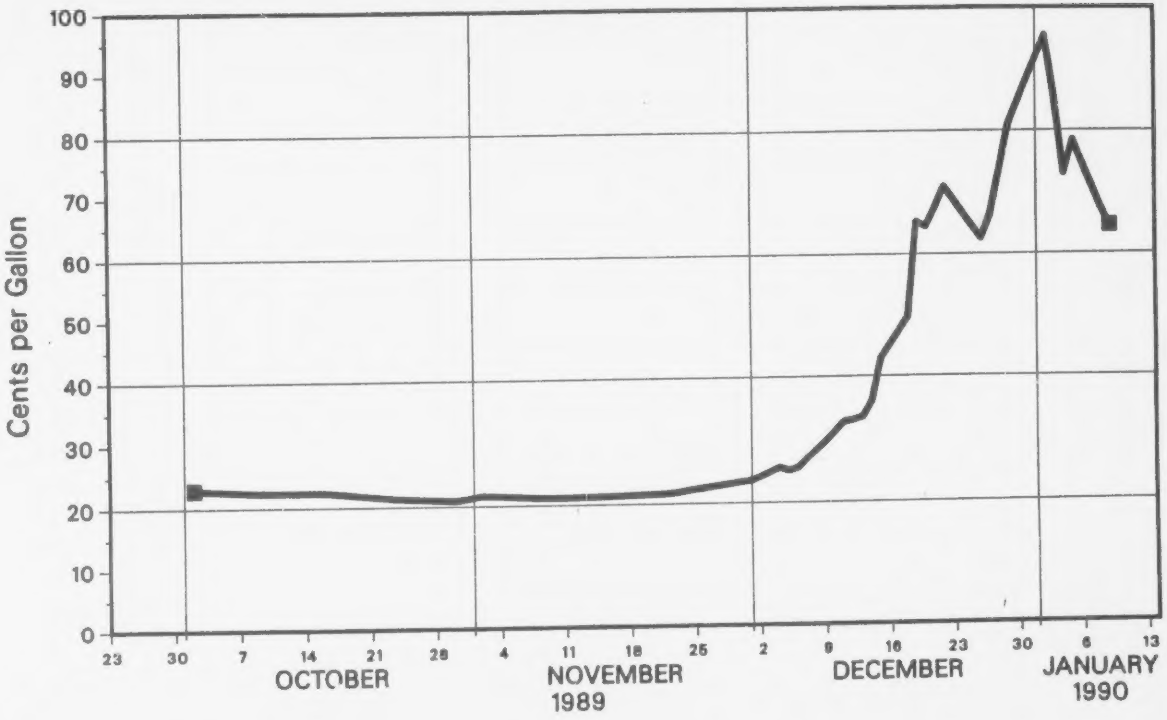
Top 4 Companies' Market Share (percent)

	1984	1985	1988	YTD 89
PADD 1A	77	80	71	76
PADD 1B	64	62	73	76
PADD 1C	49	50	52	53
PADD 2	38	40	40	38
PADD 3	31	35	45	43
PADD 4	52	54	53	59
PADD 5	51	56	56	57

Top 8 Companies' Market Share (percent)

	1984	1985	1988	YTD 89
PADD 1A	95	94	92	100
PADD 1B	85	78	85	86
PADD 1C	73	78	77	80
PADD 2	53	57	58	60
PADD 3	50	58	65	62
PADD 4	81	85	81	84
PADD 5	73	78	78	81

WHOLESALE PROPANE PRICES,
Fourth Quarter, 1989 to Current



Source: Wholesale (Conway, Kansas). Platt's Oilgram Price Report.

Wholesale and Retail Propane Prices

(Cents per Gallon)

	Wholesale		Retail									
			PADD IA			PADD IB			PADD II			PADD III
	MT. Belvieu Texas	Conway Kansas	MA	NH	VT	NJ	NY	PA	IN	OH	TN	TX
30-Nov	22.3	23.4										
1-Dec	22.5	23.6	106.3	103.3	99.3	101.0	100.0	85.0	66.0	79.6	88.6	56.7
4-Dec	24.3	25.6										
5-Dec	24.3	25.1										
6-Dec	24.8	25.6										
7-Dec	26.0	27.1										
8-Dec	26.5	28.4										
11-Dec	29.0	32.9										
12-Dec	29.0	33.1										
13-Dec	29.3	33.6										
14-Dec	30.3	36.1										
15-Dec	34.5	43.1	125.0	111.0	100.8	102.0	107.5	90.0	74.0	79.6	88.6	58.3
18-Dec	42.5	49.9										
19-Dec	50.0	65.3										
20-Dec	50.0	64.5										
21-Dec	51.3	67.5										
22-Dec	55.0	71.0										
26-Dec	51.8	62.5										
27-Dec	56.0	66.3										
28-Dec	66.0	73.6										
29-Dec	69.0	81.0										
2-Jan	70.0	95.5	143.7	144.0	140.8	136.5	140.0	119.3	100.0	109.9	119.0	90.7
3-Jan	52.0	86.0										
4-Jan	43.0	73.0										
5-Jan	56.0	78.5										
8-Jan	50.0	67.5										
9-Jan	47.5	64.5										
10-Jan	48.0	65.5										
11-Jan	48.0	62.8	145.3	149.8	153.5	141.5	146.5	132.0	101.9	120.6	119.0	91.3

SOURCES: Wholesale, Platt's Oilgram Price Report;
Retail, Energy Information Administration/State Heating Oil Program.

U.S. Propane Stocks

(Thousands of Barrels)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
88	36,688	31,050	29,951	38,282	45,985	52,196	58,731	63,594	63,074	61,771	59,226	50,427
89	45,248	36,503	32,413	36,838	43,960	49,618	56,546	60,382	60,536	56,972	52,499	NA

U.S. Propane Production

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
88	858	862	857	863	860	832	859	870	861	885	878	877	863
89	904	857	884	895	888	857	872	846	844	825	849	NA	866

U.S. Propane Imports

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
88	126	138	89	88	79	77	126	120	107	104	112	106	106
89	154	141	100	85	70	99	99	111	111	102	107	NA	107

U.S. Propane Product Supplied

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
88	1,306	1,155	954	639	662	674	745	797	951	981	1,019	1,192	923
89	1,198	1,275	1,072	796	688	730	707	804	918	1,011	1,073	NA	934

Source: Energy Information Administration

PADD I Propane Stocks

(Thousands of Barrels)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
88	2,565	2,526	2,098	2,456	2,898	3,039	3,726	4,662	4,901	4,804	4,916	3,847
89	3,865	2,926	2,297	2,629	3,051	4,039	4,854	4,827	4,876	4,757	4,931	NA

PADD I Propane Imports

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
88	22	48	24	19	18	5	28	17	19	13	29	29	22
89	41	37	22	19	16	19	21	4	17	9	22	NA	19

PADD I Propane Product Supplied

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
88	210	167	124	71	61	66	80	80	100	119	128	176	115
89	230	239	203	131	104	95	108	141	160	162	157	NA	157

Source: Energy Information Administration

Note: Product supplied data by PADD for 1988 are estimated.

PADD II Propane Stocks

(Thousands of Barrels)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
88	14,142	11,428	10,900	13,325	15,759	17,965	20,430	22,926	22,917	21,390	21,116	17,408
89	15,565	10,718	9,288	11,677	14,161	16,597	19,567	20,595	19,737	16,564	14,852	NA

PADD II Propane Imports

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
88	80	78	52	48	42	60	37	53	68	53	76	53	58
89	103	83	70	60	49	68	43	55	62	73	74	NA	67

PADD II Propane Product Supplied

(Thousands of Barrels per Day)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg
88	309	290	209	114	108	106	113	134	209	221	252	290	196
89	428	497	370	207	172	170	138	215	250	365	332	NA	286

Source: Energy Information Administration

Note: Product supplied data by PADD for 1988 are estimated.

Propane Margins: PADD I

(Cents per Gallon)

	Prices			Margins	
	Crude/ Natural Gas	Wholesale	Retail Propane	Wholesale	Retail
October	31.5	28.5	73.9	-3.0	45.4
November	33.1	28.4	76.0	-4.7	47.6
15-Dec	36.8	38.8	105.7	2.0	66.9
2-Jan	41.0	82.8	137.5	41.8	54.8
11-Jan	41.4	55.4	145.0	14.0	89.6

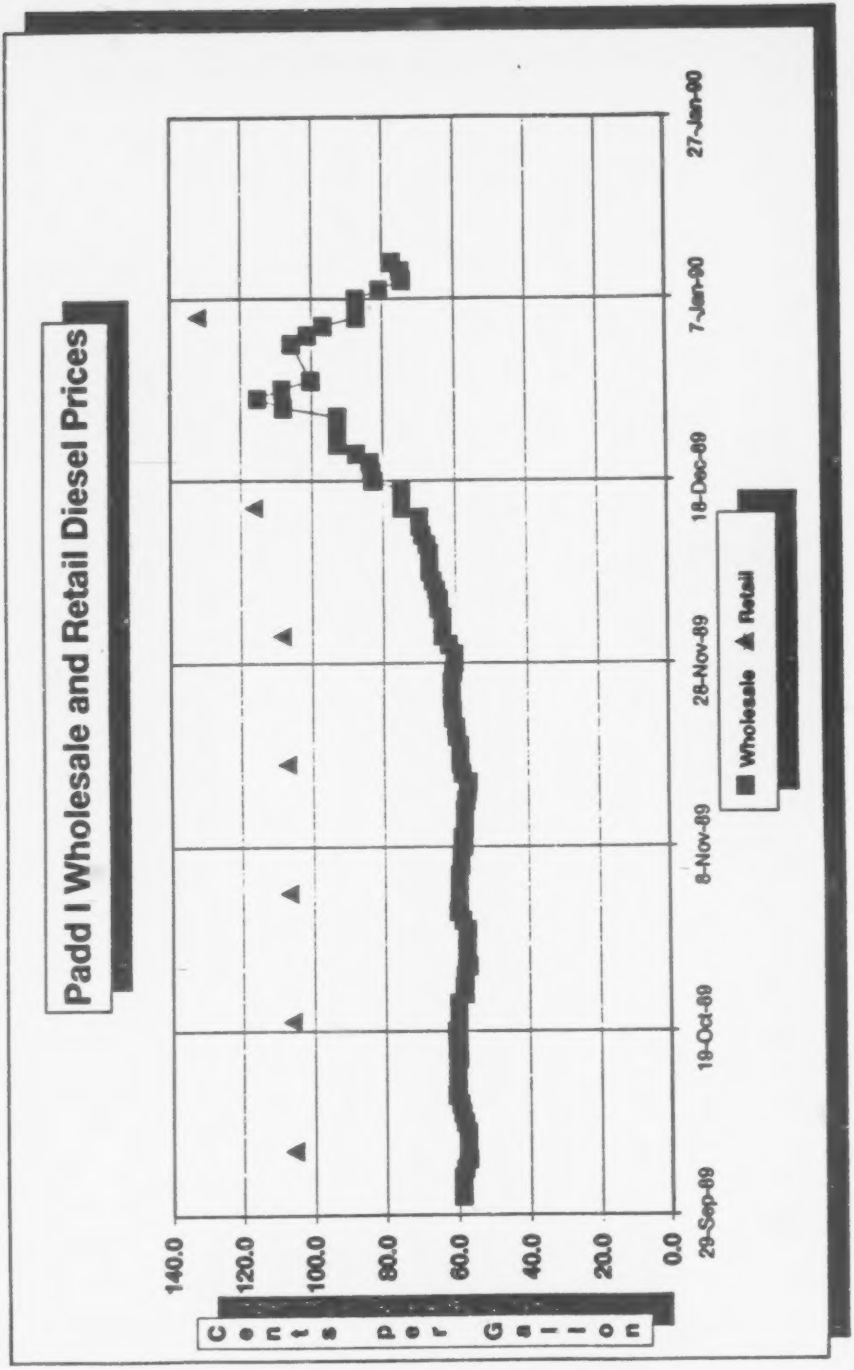
Propane Margins: PADD II

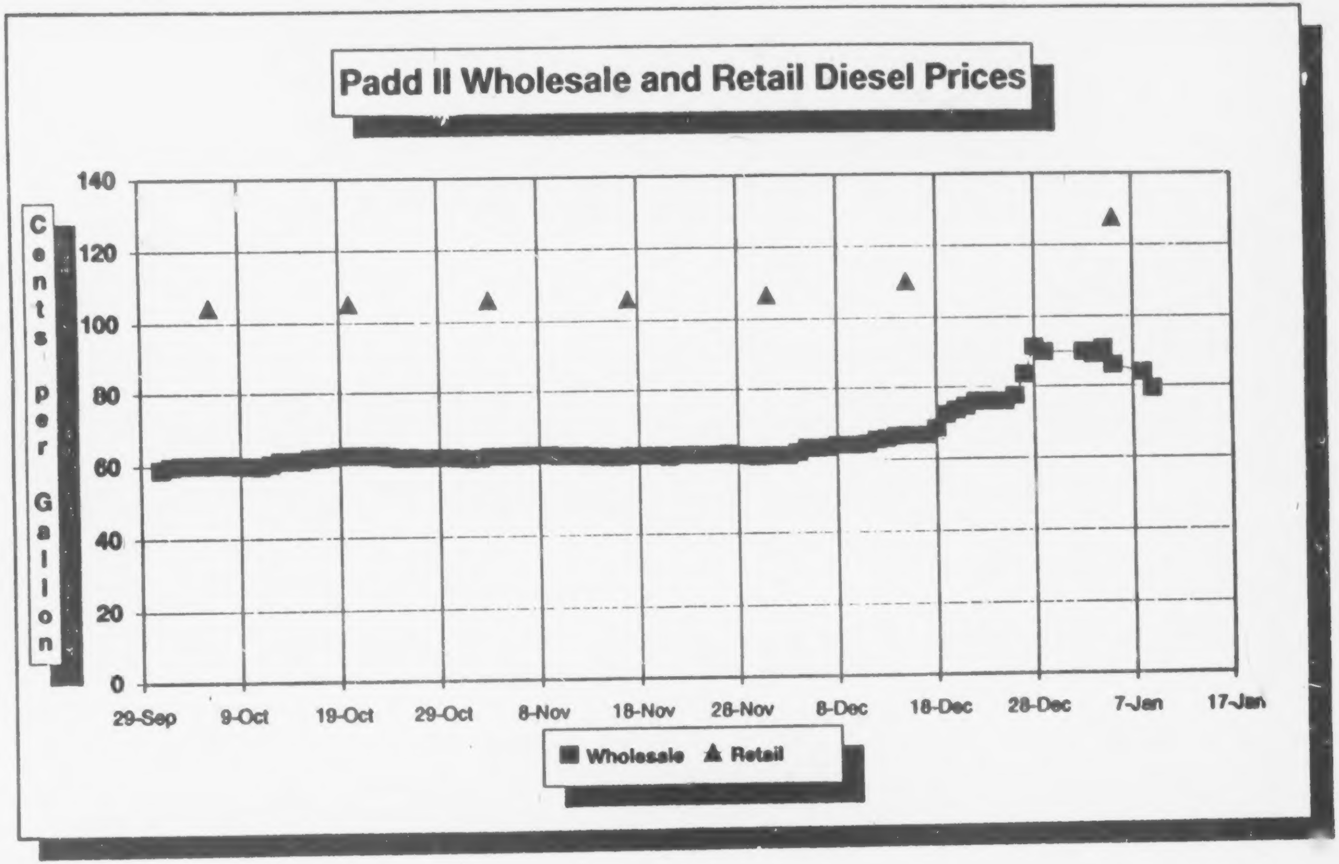
(Cents per Gallon)

	Prices			Margins	
	Crude/ Natural Gas	Wholesale	Retail Propane	Wholesale	Retail
October	31.5	24.3	58.7	-7.2	34.4
November	33.1	24.2	62.0	-8.9	37.8
15-Dec	36.8	38.8	80.7	2.0	41.9
2-Jan	41.0	82.8	110.0	41.8	27.3
11-Jan	41.4	55.4	114.0	14.0	58.6

NOTE: Crude/Natural Gas costs are a weighted average cost representing inputs into refineries and natural gas processing plants.

SOURCES: October and November, EIA Petroleum Marketing Monthly;
Other Wholesale, Platts Oilgram Price Report;
Other Retail, Energy Information Administration/State Heating Oil Program;


Padd I Wholesale and Retail Diesel Prices
Cents per Gallon
140.0
120.0
100.0
80.0
60.0
40.0
20.0
0.0
29-Sep-89
19-Oct-89
8-Nov-89
28-Nov-89
18-Dec-89
7-Jan-90
27-Jan-90
Wholesale
Retail



Padd II Wholesale and Retail Diesel Prices

Wholesale and Retail Diesel Prices

	Wholesale			Retail	
	PADD IA	PADD IB	PADD II	PADD I	PADD II
2-Oct	60.8	59.0	59.6		
6-Oct				105.9	104.5
20-Oct				106.3	105.3
3-Nov				106.7	106.1
6-Nov	63.1	62.1	62.9		
17-Nov				107.2	106.1
1-Dec				108.5	106.8
4-Dec	64.0	62.4	62.8		
15-Dec				116.4	110.4
18-Dec	74.1	71.6	67.0		
2-Jan	113.5	107.5	90.9		
5-Jan				132.2	127.7

NOTE: PADD IA is New England, PADD IB is the Mid-Atlantic Region, and PADD II is the Midwest.

SOURCES: Wholesale, Energy Information Administration/State Heating Oil Program;

Retail , EIA calculations based on Lundberg Survey data.

January 8, 1990

ENERGY EMERGENCY AUTHORITIES

I. PRINCIPAL AUTHORITIES AVAILABLE TO THE DEPARTMENT OF ENERGY TO RESPOND TO ENERGY EMERGENCIES

A. Energy Policy and Conservation Act, Pub. L. No. 94-163 (42 U.S.C. §6201 et seq.), as amended.

- Section 103 provides broad authority to limit exports of energy supplies, including coal, crude oil, petroleum products, natural gas, or petrochemical feedstocks. (42 U.S.C. §6212)

- Section 106 authorizes the President to require increased production of crude oil or natural gas on Federal lands and, subject to certain conditions, State lands, during a "severe energy supply interruption." (42 U.S.C. §6214)

- Sections 151-167 provide for creation of the Strategic Petroleum Reserve (SPR) and set forth the method and circumstances for its drawdown and distribution in the event of a "severe energy supply interruption" or to fulfill the obligations of the U.S. under the Agreement on an International Energy Program (IEP). Authority to allocate crude oil from the SPR also is provided. (42 U.S.C. §§6231-6247)

- Section 251 authorizes the President to require companies subject to the jurisdiction of the United States to divert oil supplies to other International Energy Agency (IEA) member countries in satisfaction of United States' allocation obligations. (42 U.S.C. §6271)

- Section 252 provides a limited antitrust defense and a breach of contract defense to U.S. oil companies with respect to actions taken by them to implement the information and allocation provisions of the IEP, provided that such actions are described in a voluntary agreement or plan of action. Under this authority, a "Voluntary Agreement and Plan of Action to Implement the International Energy Program" (Voluntary Agreement) was agreed to in 1976 by a number of U.S. oil companies. On January 26, 1988, the Secretary of Energy approved a "Second Plan of

Action to Implement the International Energy Program." (42 U.S.C. §6272)

- Section 254 authorizes the U.S. Secretary of State to provide the IEA with information and data related to the energy industry that is required to be submitted under the IEP. (42 U.S.C. §6274)

- Section 381 provides authority for the Federal Government's Federal Energy Management Program (FEMP), including the emergency conservation program for Federal Government facilities and other Federal Government activities. (42 U.S.C. §6361) Additional authority for the FEMP is contained in Sections 541-549 of the National Energy Conservation Policy Act (42 U.S.C. §§8251-8259) and Section 656 of the Department of Energy Organization Act (42 U.S.C. §7266).

B. Defense Production Act of 1950, Pub. L. No. 81-774 (50 U.S.C. App. §2061 et seq.).

- Section 101(a) authorizes the President to require performance on a priority basis of contracts or orders that he deems "necessary or appropriate to promote the national defense", and to allocate materials and facilities "in such manner, upon such conditions and to such extent as he shall deem necessary or appropriate to promote the national defense." (50 U.S.C. App. §2071(a)) Section 101(a) authority is not available to control the general distribution of material in the civilian market unless further findings required by Section 101(b) of the DPA are made, i.e. that the material is a "scarce and critical material essential to the national defense" and that defense needs cannot be met without causing dislocations in that market that will create "appreciable hardship." (50 U.S.C. App. §2071(b))

- Section 101(c) authorizes the President to require the allocation of, or the priority performance under, contracts or orders relating to, supplies of materials and equipment in order to maximize domestic energy supplies, if he makes certain findings with respect to the need for the materials or equipment for the exploration, production, refining, transportation, or conservation of energy supplies, or for the construction and maintenance of energy facilities. (50 U.S.C. App. §2071(c))

- Section 708 provides a limited antitrust defense for industry participating in voluntary agreements "to help provide for the defense of the United States through the development of preparedness programs and the expansion of productive capacity and supply beyond levels needed to meet essential civilian demand in the United States." (50 U.S.C. App. §2158) With respect to energy-related activities, this authority is not available for voluntary agreements to carry out the NATO oil sharing arrangement, the IEP oil sharing arrangement, or other international agreements related to petroleum between the U.S. and one or more foreign countries. (50 U.S.C. App. §2158(A)(o))

- o Section 710 authorizes the President to train and employ persons from the private sector in order to facilitate planning for and responding to emergencies. (50 U.S.C. App. §2160)

The authorities in sections 101 and 710 have been delegated to the Department by Executive Order Nos. 10480, 10647, 11790, and 11912.

C. Naval Petroleum Reserves Production Act of 1976, Pub. L. No. 94-258 (10 U.S.C. §7420 et seq.)

- o Section 7422(b) authorizes the Secretary of Energy to require production of petroleum from the Naval Petroleum Reserves at the "temporary emergency rate" (production presently is at the "maximum efficient rate"), with the approval of the President, whenever such production is needed for national defense purposes, and if such production is authorized by a joint resolution of Congress. (10 U.S.C. §7422(b))

D. Natural Gas Act, Pub. L. No. 75-688 (15 U.S.C. §717 et seq.).

- o Section 7(c) authorizes the Federal Energy Regulatory Commission, in times of natural gas emergencies, to take extraordinary regulatory actions to ensure interstate natural gas service. (15 U.S.C. §717f(c))

E. Natural Gas Policy Act of 1978, Pub. L. No. 95-621 (15 U.S.C. §3301 et seq.).

- o Sections 302 and 303, respectively, give the President emergency authority to "authorize purchases of natural gas" and to "allocate supplies of natural gas" in interstate commerce. Exercise of this authority depends upon the existence or imminence of a "severe natural gas shortage, endangering the supply of natural gas for high-priority uses." (15 U.S.C. §§3362 and 3363)

F. Federal Power Act, Pub. L. No. 66-280 (16 U.S.C. §791a *et seq*.).

- Section 202(c) permits DOE to order temporary connections of facilities and such generation, delivery, interchange, transmission or power wheeling of electric energy as in its judgment will best meet the emergency. (16 U.S.C. §824a(c))

- Sections 210 and 211 authorize the Federal Energy Regulatory Commission to order interconnections, and wheeling transmission services, if such actions are in the public interest, and would promote efficient use of the facilities in question, conserve energy, or improve system reliability. (16 U.S.C. §§824i and 824j)

G. Public Utilities Regulatory Policies Act of 1978, Pub. L. No. 95-617 (*codified in* 16 U.S.C. §2601 *et seq*. and 15 U.S.C. §717z).

- Section 607 grants the President authority, following a finding of a "severe natural gas shortage endangering the supply of natural gas for high-priority uses," to prohibit the burning of natural gas by any electric powerplant or major fuel-burning installation. Required emergency finding identical to that in the Natural Gas Policy Act. (15 U.S.C. 717z)

H. Powerplant and Industrial Fuel Use Act, Pub. L. No. 95-620 (42 U.S.C. §8301 *et seq*.).

- Section 404(a) grants the President authority to allocate coal (and to require the transportation thereof) for the use of any powerplant or major fuel-burning installation. (42 U.S.C. §8374(a)) Exercise of this authority requires a finding of a severe energy supply interruption, as defined in Section 3(8) of EPCA (42 U.S.C. §6202(8))

- Section 404(b) grants the President authority to prohibit any powerplant or major fuel-burning installation from using natural gas or petroleum, or both, as a primary energy source. (42 U.S.C. §8374(b)) Exercise of this authority requires a finding of a severe energy supply interruption, as defined in Section 3(8) of EPCA (42 U.S.C. §6202(8))

I. Atomic Energy Act of 1954, Pub. L. No. 83-703 (42 U.S.C. §2011 *et seq.*).

- Authorizes the Secretary of Energy, upon the declaration by Congress of a state of war or national emergency, to suspend any licenses granted under the Act if such action is necessary for the common defense and security. (42 U.S.C. §2138)

II. OTHER RELEVANT AUTHORITIES

A. Trade Expansion Act of 1962, Pub. L. No. 87-794 (19 U.S.C. §1801 *et seq.*).

- Based upon an investigation and finding that imports of any item threaten the national security, Section 232(b) authorizes the President to "take such action, and for such time, as he deems necessary to adjust the imports of such article...." This would include imposition of fees and/or quotas on petroleum imports. (19 U.S.C. §1862(b))

B. Export Administration Act, Pub. L. No. 96-72 (50 U.S.C. App. §2401), as amended.

- Section 7(a) authorizes the President to "prohibit or curtail the export of any goods" in order, *inter alia*, to further the foreign policy interests of the United States to protect the economy from a drain of scarce resources, or to obtain leverage against countries that aid terrorists, to carry out the policies of the Act. (50 U.S.C. App. §2406(a))

- Section 7(d) restricts exports of crude oil transported in the Trans-Alaska pipeline (Alaska North Slope crude oil). (50 U.S.C. App. §2406(d))

- Section 7(d)(3) specifies that the export restrictions imposed by this act or by other provisions of law do not apply to exports of oil to any country pursuant to a bilateral international oil supply agreement entered into by the United States before 1979, or to any country pursuant to the IEP oil sharing system. (50 U.S.C. App. §2406(d)(3))

C. International Emergency Economic Powers Act, Pub. L. No. 95-223 (50 U.S.C. §1701 *et seq.*).

- Presidential authority to declare a national emergency to deal with a threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States. Upon declaration of a national emergency, Section 203 authorizes the President to take a wide variety of actions concerning imports or exports of any property in which any foreign country or national thereof has any interest, including, for example, regulating imports of petroleum products acquired from foreign nations and nationals and requiring U.S. companies to ship petroleum acquired abroad to other nations. (50 U.S.C. §§1701-1702)

D. Trading with the Enemy Act, Pub. L. No. 65-91 (50 U.S.C. App. §1 *et seq*.).

- Section 5(b) grants the President powers similar to the International Emergency Economic Powers Act for use during wartime. (50 U.S.C. App. §5(b))

E. Clean Air Act, Pub. L. No. 84-159, as revised by Pub. L. No. 95-95 (42 U.S.C. §7401 *et seq*.).

- Section 110(f) permits the temporary modification of a State's air pollution control program to allow for use of higher sulfur content coal, upon a Presidential finding of a severe national or regional energy emergency. (42 U.S.C. §7410 (f))

F. Interstate Commerce Act, as revised by Pub. L. No. 95-473 (49 U.S.C. §10101 *et seq*.).

- Permits the Interstate Commerce Commission (ICC) to authorize the entry of new motor carriers or water carriers into temporary service if any area has immediate, unmet needs for motor transportation services. This could help assure movement of essential petroleum products. (49 U.S.C. §10928)
- Authorizes ICC to issue priority orders during an emergency situation for rail movement of commodities including petroleum products. (49 U.S.C. §11123)

G. Outer Continental Shelf Lands Act, Pub. L. 83-212, as amended by Pub. L. No. 95-372 (43 U.S.C. §1331 *et seq*.).

- Grants to the United States during "time of war, or when the President shall so prescribe," the right of first refusal to purchase minerals from the Outer Continental Shelf at market prices. (43 U.S.C. §1341(b))

H. Mineral Leasing Act, Pub. L. No. 66-146 (30 U.S.C. §181 *et seq*.).

- Grants to the United States the right to demand that any royalty accruing to it under an oil or gas lease be paid in oil or gas. (30 U.S.C. §192)

I. Disaster Relief Act of 1974, Pub. L. No. 93-288 (42 U.S.C. §5121 *et seq*.).

- Upon finding that an emergency or major disaster exists pursuant to 42 U.S.C. §5141, the President may direct any Federal agency to utilize its available resources and personnel in support of State and local disaster assistance efforts (42 U.S.C. §§5142(a), 5145, 5146)

J. Foreign Assistance Act of 1961, Pub. L. No. 87-195 (22 U.S.C. §2151 *et seq*.).

- Empowers the President to allow any Federal agency to furnish services and commodities on an advance-of-funds or reimbursement basis to friendly countries and certain international organizations (22 U.S.C. §2357), and to waive certain regulations governing the making, performance, amendment, or modification of contracts and the expenditure of funds by the Government, if the President determines such action to be in furtherance of the purpose of the Act to "support or promote economic or political stability" through provision of foreign assistance. (22 U.S.C. §2393(a))

K. Magnuson Act, Pub. L. No. 65-24, as amended by Pub. L. 96-70 (50 U.S.C. §191 *et seq*.).

- Authorizes the Secretary of Transportation to issue regulations governing the movement of any vessel within the U.S. territorial waters, upon a Presidential declaration of a national emergency by reasons of actual or threatened war, insurrection of invasion, or disturbance or threatened disturbance of the international relations of the United States. (50 U.S.C. §191)

L. Ports and Waterways Safety Act, Pub. L. No. 92-340, as amended by Pub. L. No. 95-474 (33 U.S.C. §1221 *et seq*.).

- Authorizes the Secretary of Transportation to establish vessel traffic systems for ports, harbors and other waters subject to congested vessel traffic, and to control vessel traffic in areas determined to be especially hazardous, in order to prevent damage to or destruction or loss of any vessel or structure in U.S. navigable waters or any land structure or shore area immediately adjacent to those waters. (33 U.S.C. §1223)

MEMORANDUM OF LAW

Legal Authorities Available to the President to Respond to a Severe Energy Supply Interruption or Other Substantial Reduction in Available Petroleum Products

Office of Legal Counsel
Department of Justice
November 15, 1982

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GLOSSARY OF ABBREVIATIONS

DPA	Defense Production Act of 1950
EAA	Export Administration Act of 1979
EECA	Emergency Energy Conservation Act of 1979
EEPA	Energy Emergency Preparedness Act of 1982
EPAA	Emergency Petroleum Allocation Act of 1975
EPCA	Energy Policy and Conservation Act
ESA	Energy Security Act
FEMA	Federal Emergency Management Agency
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
FPM	Federal Personnel Manual
FTC	Federal Trade Commission
FUA	Powerplant and Industrial Fuel Use Act of 1978
IEA	International Energy Agency
IEEPA	International Emergency Economic Powers Act
IEP	International Energy Program
IPR	Industrial Petroleum Reserve
Mer	Maximum efficient rate of production
MLLA	Mineral Lands Leasing Act
NATO	North Atlantic Treaty Organization
NEA	National Emergencies Act
NESO	National Emergency Sharing Organization
NGA	Natural Gas Act
NGPA	Natural Gas Policy Act
NPRs	Naval Petroleum Reserves
PURPA	Public Utility Regulatory Policies Act of 1978
SPR	Strategic Petroleum Reserve
TEA	Trade Expansion Act of 1962
Ter	Temporary emergency production rate
TWEA	Trading with the Enemy Act
WOCs	Without Compensation Employees

MEMORANDUM OF LAW

Legal Authorities Available to the President To Respond to a Severe Energy Supply Interruption or Other Substantial Reduction In Available Petroleum Products

INTRODUCTION

This memorandum is submitted in response to § 3 of the Energy Emergency Preparedness Act of 1982 ("EEPA"), Pub. L. No. 97-229, 96 Stat. 248 (1982). That section amends Title II of the Energy Policy and Conservation Act, 42 U.S.C. § 6201 *et seq.*, by adding, *inter alia*, a new § 272(a). Section 272(a) directs the Attorney General, in consultation with the Secretary of Energy, to prepare for transmission by the President to Congress a "Memorandum of Law" describing the "nature and extent of the authorities available to the President under existing law to respond to a severe energy supply interruption or other substantial reduction in the amount of petroleum products available in the United States."[1] Section 272(a) provides that the Memorandum of Law shall address the legal bases for certain specific emergency preparedness activities to deal with a petroleum shortage,[2] and to distinguish among the threshold standards for activation of the President's statutory authorities.[3]

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[1] This Memorandum was prepared by the Office of Legal Counsel of the Department of Justice, at the direction of and under the supervision of the Attorney General, in consultation with the Department of Energy. Assistance was also provided by the Antitrust Division and Land and Natural Resources Division of the Department of Justice, the Department of Defense, the Department of State, and the Federal Emergency Management Agency.

[2] Section 272(a)(3)(A) specifies that the Memorandum include the following subjects:

> (i) activities of the United States in support of the international energy program and the December 10, 1981, International Energy Agency agreement entitled 'Decision on Preparation for Future Supply Disruptions' including—
>
> (I) the National Emergency Sharing Organization;
> (II) emergency sharing systems; and
> (III) the supply right project;
>
> (ii) activities of the United States pursuant to its energy emergency preparedness obligations to the North Atlantic Treaty Organization;
>
> (iii) development and use of the Strategic Petroleum Reserve;

(Continued)

In order to implement fully the intent of the EEPA, we have prepared the following analysis of the primary statutory authorities that would be available to the President in the event of a severe energy supply interruption. In addition to describing the requirements, scope, and limitations of those statutory authorities, we attempt to address each of the legal issues specifically raised by Congress during consideration of the EEPA and the legal bases for the activities enumerated in § 272(a)(3). Consistent with the scope and legislative intent of the EEPA,[4] the analysis focuses on statutory authorities that could be used to respond to a "petroleum emergency"—*i.e.*, standby authorities that could be exercised in the event of a sudden substantial reduction in petroleum products available to the United States.[5] We generally do not address the President's broad authority to take actions to reduce the likelihood that any of these "emergency" authorities will ever have to be exercised, or particular statutory authorities with respect to energy emergencies resulting from a shortfall in energy sources other than petroleum.

(Continued)

(iv) Government incentives to encourage private petroleum product stocks;

(v) reactivation of the following Executive Manpower Reserves:

(I) the Emergency Electric Power Reserve;

(II) the Emergency Petroleum and Gas Reserve; and

(III) the Emergency Solid Fuels Reserve;

(vi) energy emergency response management in coordination with State and local governments; and

(vii) emergency public information activities; . . .

[3] Section 272(a)(3)(B) provides that the Memorandum should distinguish among—

(i) situations involving limited or general war, international tensions that threaten national security, and other Presidentially declared emergencies;

(ii) events resulting in activation of the international energy program; and

(iii) events or situations less severe than those described in clauses (i) and (ii).

[4] *See* S. Rep. No. 293, 97th Cong., 2d Sess. 4-5 (1982); H.R. Rep. No. 585, 97th Cong., 2d Sess. 1-2 (1982).

[5] We use the term "petroleum" or "petroleum products" in this Memorandum to include those energy sources that are included in the definition of "petroleum products" in § 3(5) of the Energy Policy and Conservation Act, 42 U.S.C. § 6202(5), *i.e.*, "crude oil, residual fuel oil, or any refined petroleum product (including any natural [gas] liquid and any natural gas liquid product)."

It is important to recognize at the outset that any memorandum of law discussing the powers of the President in the context of non-existent, necessarily incomplete and hypothetical facts is of limited utility and should not be regarded as decisive or exhaustive of the President's legal authority to take any specific action based on a factual situation that may arise in the future. The exercise of the various broad powers of the President to deal with "emergencies" is so often tied to the particular facts and circumstances confronting the President at that time that a general and hypothetical discussion of his authority should not and cannot be viewed as dispositive of his authority in actual emergencies.[6] *See generally Dames & Moore* v. *Regan*, 453 U.S. 654, 660-62, 669 (1981).

Finally, the purpose of this Memorandum is limited to outlining the nature and scope of the statutory authorities available to the President. The Memorandum does not address whether or how the President should exercise particular authorities. That question is primarily a policy, rather than a legal, matter, and therefore outside the scope of this Memorandum. In that regard, it should be noted that, as described more fully below, the available statutory authorities generally provide the President with broad discretion to determine if, when, and how they should be exercised, taking into account the facts of any future energy emergency and the President's best judgment as to how to prevent or deal with the emergency situation.

Part I of this Memorandum outlines the scope and applicability of existing statutory authorities available to the President to deal with a petroleum emergency. Part II describes how those statutory authorities may support or limit the particular energy preparedness activities enumerated in § 272(a)(3)(A). Part III groups the statutory authorities according to the three triggering situations listed in § 272(a)(3)(B), to the extent consistent with the specific provisions of those statutes.

---

[6] For that reason, we cannot attempt here to discuss whatever inherent constitutional powers the President may have, in the absence of specific statutory authority, to deal with a future petroleum emergency. *See generally Youngstown Sheet & Tube Co.* v. *Sawyer*, 343 U.S. 579, 637 (1952) (Jackson, J., concurring). The existence or scope of such inherent powers can only be addressed in the context of a particular emergency situation.

I. Statutory Authorities

A number of statutes currently provide the President with authority that may be available in the event of a substantial domestic or international shortfall in petroleum supplies, ranging from direct authority to allocate and to restrict imports or exports of petroleum products, to authority to undertake or facilitate energy emergency preparedness planning and programs. The scope of the President's authority under these statutes necessarily depends on the particular facts presented by any future petroleum shortage, and therefore it is difficult, if not impossible, to resolve in the abstract all of the legal issues concerning the nature and extent of that authority. In particular, to the extent that the President's authority under certain statutes rests on a discretionary presidential finding, for example, that an emergency situation exists or that actions are necessary and appropriate "in the national interest," to promote the "national defense," or to fulfill international obligations of the United States, it is impossible to determine in the absence of specific facts when exercise of that authority would be consistent with the terms of the statute. This Memorandum therefore can only attempt to outline the terms of the statutes and describe generally the authority and any limitations on that authority contained in those statutes as written.

Among these authorities, the Energy Policy and Conservation Act,[7] the Defense Production Act of 1950,[8] and the Trade Expansion Act of 1962,[9] provide the President, in a petroleum emergency meeting the requirements of those statutes, with some specific authority to affect or control the distribution of petroleum products, as well as other authority to mitigate or plan for such an emergency. Additional authority that may be available to the President, depending on the circumstances of any petroleum emergency, is contained in the International Emergency Economic Powers Act,[10] the Emergency Energy Conservation Act of 1979,[11] the Export Administration Act of 1979,[12] and in numerous miscellaneous statutes such as the Public Utility Regulatory Policies Act of 1978,[13] the Powerplant

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[7] 42 U.S.C. § 6201 *et seq.*, as amended by Pub. L. No. 97-229, 96 Stat. 248 (1982).

[8] 50 U.S.C. app. § 2061 *et seq.*

[9] 19 U.S.C. § 1801 *et seq.*

[10] 50 U.S.C. § 1701 *et seq.*

[11] 42 U.S.C. § 8501 *et seq.*

[12] 50 U.S.C. app. § 2401 *et seq.*

[13] Pub. L. No. 95-617, 92 Stat. 3117 (1978), *codified in* 16 U.S.C. § 2601 *et seq.* & 15 U.S.C. § 717z.

and Industrial Fuel Use Act of 1978,[14] the Federal Power Act,[15] the Natural Gas Act,[16] the Natural Gas Policy Act,[17] the Mineral Lands Leasing Act,[18] the Outer Continental Shelf Lands Act,[19] the Clean Air Act,[20] the Interstate Commerce Act,[21] the Disaster Relief Act of 1974,[22] the Magnuson Act,[23] and the Foreign Assistance Act of 1961.[24]

A. Energy Policy and Conservation Act

The Energy Policy and Conservation Act ("EPCA"), 42 U.S.C. § 6201 *et seq.*, provides the President with discretionary authority to respond to an actual or potential shortfall in domestic or international petroleum supplies, including the power to: restrict exports of energy supplies; require accelerated production of crude oil or natural gas from designated fields; establish and use a Strategic Petroleum Reserve; direct the preparation and implementation of energy conservation contingency plans; and take actions necessary to implement certain international obligations of the United States.[25]

With the exception of export restrictions promulgated under § 103,[26] the President's authority under the EPCA is generally contingent on a finding that the actions taken are necessary to meet a "severe energy supply interruption" or to fulfill "obligations of the United States under the international energy program" ("IEP").[27] A "severe energy supply interruption" is defined by § 3(8) of the Act, 42 U.S.C. § 6202(8), as a "national energy supply shortage which the President determines—

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[14] 42 U.S.C. § 8301 *et seq.*

[15] 16 U.S.C. § 791a *et seq.*

[16] 15 U.S.C. § 717 *et seq.*

[17] 15 U.S.C. § 3301 *et seq.*

[18] 30 U.S.C. § 181 *et seq.*

[19] 43 U.S.C. § 1331 *et seq.*

[20] 42 U.S.C. § 7401 *et seq.*

[21] 49 U.S.C. § 10101 *et seq.*

[22] 42 U.S.C. § 5121 *et seq.*

[23] 50 U.S.C. § 191 *et seq.*

[24] Pub. L. No. 87-195, 75 Stat. 424 (1961), as amended, *codified in* scattered sections of 7, 22, and 42 U.S.C.

[25] The EPCA also extended the crude oil and petroleum product pricing authority of the Emergency Petroleum Allocation Act of 1973 ("EPAA"), 15 U.S.C. § 751 *et seq.*; established price controls on previously exempt domestic crude oil; established maximum weighted average first sale prices on all domestic crude oil; and directed the President to develop a rationing contingency plan. These provisions of the EPCA expired with the EPAA on September 30, 1981. In addition, § 104 of the EPCA amended § 101 of the Defense Production Act of 1950, 50 U.S.C. app. § 2071, adding a new subsection (c) that authorizes the President to require the allocation of supplies of materials and equipment in order to maximize domestic energy supplies. That provision is discussed *infra* at 27-31.

[26] 42 U.S.C. § 6212. See discussion *infra* at 7-8.

> (A) is, or is likely to be, of significant scope and duration, and of an emergency nature;
>
> (B) may cause major adverse impact on national safety or the national economy; and
>
> (C) results, or is likely to result, from an interruption in the supply of imported petroleum products, or from sabotage or an act of God."

The IEP, established in 1974 by the Agreement on an International Energy Program ("Agreement"), to which the United States is a signatory, provides for coordinated action among the 21 members ("Participating Countries") in order to decrease their vulnerability to supply disruptions and dependence on imported oil.[28] The Agreement imposes four principal substantive obligations: (1) the maintenance of emergency oil reserves (Chapter I); (2) a program of contingent demand restraint measures (Chapter II); (3) a program of international sharing of oil supplies during a supply emergency (Chapter III); and (4) the establishment of an information system on the international oil market (Chapter V). A critical feature of the IEP is the agreement on a "trigger" level of shortage in petroleum supplies that may activate certain emergency measures to ease disruption caused by the shortage. This emergency system may be activated only in the event of a 7% or greater shortfall

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[27] *See* 42 U.S.C. §§ 6214(a)(2)(B), 6214(b)(2), 6214(c), 6261(b), 6271(a), 6272(b).

[28] Section 3(7) of the EPCA, 42 U.S.C. § 6202(7), defines the IEP as follows:

> The term "international energy program" means the Agreement on an International Energy Program, signed by the United States on November 18, 1974, including (A) the annex entitled "Emergency Reserves," (B) any amendment to such Agreement which includes another nation as a party to such Agreement, and (C) any technical or clerical amendment to such Agreement.

The effect of this definition is to limit the use of the authority provided by the EPCA to actions taken in support of the Agreement as it was signed by the United States in 1974; the definition precludes use of the EPCA in support of actions taken to implement any future substantive amendments to the Agreement. In addition, § 255 of the EPCA, 42 U.S.C. § 6275, contains a caveat that, "[w]hile the authorities contained in [subchapter II of the EPCA] may, to the extent authorized . . . , be used to carry out obligations incurred by the United States in connection with the International Energy Program, [subchapter II] shall not be construed in any way as advice and consent, ratification, endorsement, or other form of congressional approval of the specific terms of such program."

in oil supplies of one or all of the Participating Countries, as determined in accordance with procedures set out in Chapter IV of the Agreement. Once the emergency system has been activated, all Participating Countries are obligated to share in the shortfall. This may include, depending on the circumstances, the sharing of oil supplies among Participating Countries, based on a calculation of "supply rights" that assumes a certain amount of the shortfall will be absorbed through demand restraint and use of emergency reserves.[29]

1. Section 103. Limitations on Exports

Section 103 of the EPCA, 42 U.S.C. § 6212, grants the President certain authority to limit exports of energy supplies, including petroleum products. Subsection (a), 42 U.S.C. § 6212(a), provides the President with discretionary authority to promulgate a rule restricting exports of coal, petroleum products, natural gas, or petrochemical feedstocks, and related materials and equipment. To facilitate implementation of any rule issued pursuant to subsection (a), the President may require the Secretary of Commerce to implement export restrictions pursuant to procedures established by the Export Administration Act of 1979 ("EAA"), 50 U.S.C. app. § 2401 *et seq.* *See* 42 U.S.C. § 6212(c). The Secretary of Commerce may implement those restrictions without regard to the direction in the EAA that export controls be limited to those necessary, *inter alia*, "to reduce the serious inflationary impact of foreign demand."[30] Subsection (b), 42 U.S.C. § 6212(b), requires the President to promulgate a rule prohibiting the export of crude oil and natural gas produced in the United States. The President may exempt crude oil or natural gas exports from that prohibition only if he determines that an exemption would be consistent with the national interest and the purposes of the EPCA. *Id.*

The President's authority to restrict exports of energy supplies and materials under § 103(a) or to waive mandatory restrictions on the export of crude oil and natural gas under § 103(b), is subject to several limitations. First, he must find that the restrictions or exemptions are "appropriate and necessary" to carry out the purposes of the EPCA [21] and consistent with the national interest. 42 U.S.C. § 6212(a), (b)(1), (d). The President's determination of the "national interest" (or the parallel determination by the Secretary of Commerce in implementing export restrictions under this section) must take into account the need to leave uninterrupted or unimpaired: (1) exchanges in similar quantity for convenience or increased efficiency of transportation with persons or the government of a foreign state; (2) temporary exports across parts of an adjacent foreign state; and (3) the historical trading relations of the United States with Canada and Mexico. *Id.* § 6212(d). Second, with respect to restrictions on supplies of materials or equipment other than primary energy sources, the President must determine that the restrictions are necessary either to maintain or further exploration, production, refining, or transportation of energy supplies, or for the construction or maintenance of energy facilities, within the United States. *Id.* § 6212(a)(2). Third, exemptions from the mandatory export restrictions on crude oil and natural gas required by subsection (b) must be based on a "reasonable classification or basis," such as the purpose for export, class of seller or purchaser, or country of destination. *Id.* § 6212(b)(2).

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[29] The scope and operation of the IEP are discussed more fully *infra* at 53-56.

[30] *See* 50 U.S.C. app. § 2402(2)(C). The EAA is discussed *infra* at 48-50.

2. Section 106. Accelerated Production Rates

Section 106(a)(1) of the EPCA, 42 U.S.C. § 6214(a)(1), requires the Secretary of the Interior to determine, by rule, a "maximum efficient rate of production" ("Mer") and a "temporary emergency production rate" ("Ter") for each field on federal lands that produces or is capable of producing significant volumes of crude oil and/or natural gas.[22] Subsection (b) of § 106, 42 U.S.C. § 6214(b), provides that each state may establish a Mer and Ter for any field in the state, other than a field on federal lands, that produces or is capable of producing significant volumes of natural gas or crude oil, and subsection (c), 42 U.S.C. § 6214(c), provides that the Secretary of the Interior may establish a Mer and Ter for unitized fields on federal and non-federal lands for which no Mer or Ter has otherwise been established.

Except with respect to the Naval Petroleum Reserves ("NPRs")[23], the President may, at any time, require natural gas or crude oil to be produced from fields on federal lands at the Mer. If the President determines that a severe energy supply interruption exists, he may also authorize production from federal fields at the Ter, or from non-federal or unitized fields on federal and non-federal lands at the Mer or Ter, if such rates have been established by the states or the Secretary of the Interior pursuant to subsections (b) and (c). 42 U.S.C. § 6214(a)(2), (b)(2), (c). This authority could be used to increase domestic crude oil supplies generally by increasing the rate of production from federal fields to the Mer, or, in response to an interruption in petroleum supplies that triggers a presidential finding of a severe energy supply interruption, by increasing production from federal fields to the Ter and from other fields to the Mer or Ter.

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[21] The purposes of the EPCA are broadly defined in § 2, 42 U.S.C. § 6201, to include the following:

(1) to grant specific standby authority to the President, subject to congressional review, to impose rationing, to reduce demand for energy through the implementation of energy conservation plans, and to fulfill obligations of the United States under the international energy program;

(2) to provide for the creation of a Strategic Petroleum Reserve capable of reducing the impact of severe energy supply interruptions;

(3) to increase the supply of fossil fuels in the United States, through price incentives and production requirements;

(4) to conserve energy supplies through energy conservation programs, and, where necessary, the regulation of certain energy uses;

(5) to provide for improved energy efficiency of motor vehicles, major appliances, and certain other consumer products;

(6) to reduce the demand for petroleum products and natural gas through programs designed to provide greater availability and use of this Nation's abundant coal resources; and

(7) to provide a means for verification of energy data to assure the reliability of energy data.

[22] The Mer is defined as the maximum rate of production that "may be sustained without loss of ultimate recovery of crude oil or natural gas, or both, under sound engineering and economic principles." 42 U.S.C. § 6214(e)(1). The Ter is the maximum rate of production, above the Mer, that "may be maintained for a temporary period of less than 90 days without reservoir damage and without significant loss of ultimate recovery of crude oil or natural gas, or both . . . ." *Id.* § 6214(e)(2).

[23] The NPRs, which are established pursuant to 10 U.S.C. § 7420 *et seq.*, are exempt from § 106 of the EPCA. *See* 42 U.S.C. § 6214(f). Section 7422(c) of title 10 authorized and directed production of the NPRs at the Mer for up to six years, and permitted the President to extend such production for additional periods not to exceed three years each. Mer petroleum has been extended until April 1985. 17 Pres. Doc. 1097 (Oct. 12, 1981). Section 7422(b) of title 10 authorizes the Secretary of Energy to require production of petroleum from the NPRs at the Ter, with the approval of the President, whenever such production is needed for national defense and if such production is authorized by a joint resolution of Congress. 10 U.S.C. § 7422(b)(2).

3. Sections 151-161. Strategic Petroleum Reserve

Sections 151-161 of the EPCA, 42 U.S.C. §§ 6231-6241, *amended by* Pub. L. No. 97-229, § 4, 96 Stat. 250 (1982), provide for creation of a Strategic Petroleum Reserve ("SPR") to be available for the purposes of reducing the impact of future disruptions in supplies of petroleum products and fulfilling obligations of the United States under the IEP,[84] and set forth the method and circumstances for drawdown and distribution of the SPR.

a. Establishment of the SPR

Section 154 of the EPCA directs the establishment of an SPR for storage of up to one billion barrels of petroleum products and preparation of a plan ("SPR Plan") outlining proposals for designing, constructing and filling the storage and related facilities of the Reserve. 42 U.S.C. § 6234(a), (b). The SPR Plan must also include a description of the method of drawdown and distribution of the SPR.[85] *Id.* § 6234(e)(12).

In addition, the SPR Plan must provide either for establishment and maintenance on a regional basis of a "Regional Petroleum Reserve" containing sufficient volumes of residual fuel oil or any refined petroleum product to "provide substantial protection against an interruption or reduction in imports of such oil or product," or for storage in the SPR of "substitute" volumes of crude oil and petroleum products sufficient to meet

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[84] As discussed *infra*, in the discretion of the President, the SPR may be used to fulfill the obligations of the United States under the IEP to participate in an international oil sharing plan in the event of activation of the IEP emergency system. *See infra* at 12.

[85] The SPR Plan and any amendments thereto must be transmitted to Congress pursuant to the procedures provided in 42 U.S.C. § 6421 for approval of "major energy actions." *See* 42 U.S.C. § 6239. We believe that procedures such as these, which contemplate either a one-House veto or a two-House approval mechanism, violate the presentation requirement and, insofar as a one-House veto is involved, the bicameralism requirements of Art. I, § 7, cls. 2 & 3 of the Constitution. These clauses require that all congressional actions having the force and effect of law must be adopted by both Houses of Congress and presented to the President for his approval or veto. In addition, legislative veto provisions such as involved here, which purport to allow Congress to play a direct and significant role in the execution of the law, are inconsistent with the principle of separat... of powers. *See Consumers Union of U.S., Inc.* v. *Federal Trade Comm'n*, No. 82-01512 (D.C. Cir. Oct. 22, 1982) (*per curiam*) (*en banc*); *Consumer Energy Council of America* v. *Federal Energy Regulatory Comm'n*, 673 F.2d 425 (D.C. Cir. 1982), pending before the Supreme Court as Nos. 81-2008, 81-2020, 81-2151, 81-2171, 82-177 and 82-209; *Immigration and Naturalization Service* v. *Chadha*, 634 F.2d 408 (9th Cir. 1980), pending before the Supreme Court as Nos. 80-1832, 81-2170 and 80-2171.

regional needs. 42 U.S.C. § 6237. Section 154(d) of the EPCA, 42 U.S.C. § 6234(d), further directs that the Plan "shall be designed to assure, to the maximum extent practicable, that each noncontiguous area of the United States which does not have overland access to domestic oil production has its component of the [SPR] within its respective territory."

As part of the SPR, the Secretary of Energy[86] may create an Industrial Petroleum Reserve ("IPR"). 42 U.S.C. § 6236. An IPR would consist of private inventories of petroleum products required to be maintained in excess of normal requirements. The Secretary of Energy has the discretionary authority to establish such a reserve by requiring importers and refiners of petroleum products to acquire, store, and maintain supplies of petroleum products up to 3% of the amount they imported or refined in the previous calendar year. In establishing and maintaining an IPR, the Secretary is required to take steps to avoid inequitable economic impacts on refiners and importers, and to maintain an economically sound and competitive petroleum industry. *Id.*

b. Filling the SPR

To implement the SPR, the Secretary of Energy is authorized to acquire petroleum products by purchase, exchange, or other means; the Secretary may also store or exchange crude oil produced from federal lands, including NPRs oil and oil that the United States is entitled to receive as royalties. 42 U.S.C. § 6240. Amendments to the EPCA added in 1982 by the EEPA require the President, to the extent funds are appropriated by Congress, to increase the volume of petroleum products in the SPR at a "minimum fill rate" of 300,000 barrels per day, or 220,000 barrels per day if the President finds that the higher rate would not be in the national interest, until the SPR reaches at least 500,000,000 barrels. Pub. L. No. 97-229, § 4(a), 96 Stat. 250 (1982).[87] In order to facilitate achievement of this fill rate, the EEPA authorizes the leasing or other use of "interim storage facilities." *Id.* § 4(b).

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[86] Responsibility for developing and implementing the SPR was originally given to the Administrator of the Federal Energy Administration. Pursuant to the Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, the Secretary of Energy is responsible for all functions relating to the SPR. *See* 42 U.S.C. § 7151.

[87] If funds are available to achieve a fill rate higher than the required "minimum fill rate," the EEPA provides that the fill rate be the "highest practicable fill rate achievable." Pub. L. No. 97-229, § 4(a)(1)(D), 96 Stat. 251 (1982). After the SPR reaches 500,000,000 barrels, the President's obligation is to "seek to undertake and . . . continue" a fill rate of 300,000 barrels per day until the SPR reaches 750,000,000 barrels. *Id.* § 4(a)(2).

c. Drawdown and Distribution of the SPR

Section 161, 42 U.S.C. § 6241, governs the drawdown and distribution of petroleum products in the SPR. Drawdown and distribution must be accomplished in accordance with an effective Distribution Plan.[38] The Distribution Plan can only be implemented upon a finding by the President that distribution of the Reserve is required either by (1) a severe energy supply interruption or (2) obligations of the United States under the IEP. *Id.*

The President's authority to withdraw oil in the SPR includes the authority to impose allocation and price controls on that oil. Under § 161(e), 42 U.S.C. § 6241(e), the Secretary of Energy is specifically authorized to provide by rule "for the allocation of any petroleum product withdrawn from the [SPR] in amounts specified in (or determined in a manner prescribed by) and at prices specified in (or determined in a manner prescribed by) such rules. Such price levels and allocation procedures shall be consistent with the attainment, to the maximum extent practicable, of the objectives specified in [the EPAA]." The Department of Energy has adopted regulations that would govern the allocation and pricing of SPR crude oil, in the event that such oil were allocated rather than sold through price competition, after a drawdown of the reserve had been triggered by one of the enumerated circumstances. *See* 10 C.F.R. Part 220.

4. Sections 201-202. Energy Conservation Contingency Plans

Under § 201 of the EPCA, 42 U.S.C. § 6261, the President is required to develop one or more "energy conservation contingency plans," which are defined by § 202, 42 U.S.C. § 6262, as plans "which impose reasonable restrictions on the public or private use of energy that are necessary to reduce energy consumption."[39] The President is required to submit any energy conservation contingency plan or amendments thereto to Congress accompanied by a statement explaining the need for, rationale of, and operation of the plan. The plan must take into account its potential economic impacts, including its effects on vital industrial sectors of the economy, employment, the economic vitality of states and regional areas, the availability and price of consumer goods and services, the gross national product, and any possible anticompetitive effects. *Id.* § 6261(b), (c), (f). Section 201(b)(2) further requires that the contingency plan be approved by a resolution by each House of Congress.[40] *Id.* § 6261(b)(2). In order to implement an effective emergency contingency plan, the President must find that implementation is required by a severe energy supply interruption or by the need to fulfill the obligations of the United States under the IEP. *Id.* § 6261(b)(3).

The President's authority to prescribe particular demand restraint or energy conservation measures pursuant to § 201 is limited by § 202(a)(2), 42 U.S.C. § 6262(a)(2), which prohibits any energy conservation contingency plan from imposing any rationing, tax, tariff, or user fee, from providing for any credit or deduction in computing any tax, and from containing any provision respecting the price of petroleum products. A plan may provide for exemption of individual states or political subdivisions if the President determines a comparable program is in effect in such state or subdivision or that "special circumstances" exist. *See id.* § 6262(b).

5. Sections 251, 252, 254. Authorities in Support of the Allocation and Information Provisions of the IEP

Sections 251, 252, and 254 of the EPCA, 42 U.S.C. §§ 6271, 6272, 6274, *as amended by* Pub. L. No. 97-229, § 2, 96 Stat. 248 (1982), provide authority for the President and cooperating U.S. oil companies to take action to implement obligations of the United States under the allocation and information provisions contained in Chapters III, IV, and V of the IEP.

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[38] The currently effective SPR Distribution Plan was submitted to Congress on October 31, 1979. The EEPA requires the Secretary of Energy to transmit a new drawdown plan to Congress by December 1, 1982, as an amendment to the existing SPR Plan. The EEPA specifies that this amendment shall take effect on the date of transmittal to Congress and shall not be subject to provisions in § 159(e) of the EPCA, 42 U.S.C. § 6239(e), relating to congressional review of SPR Plan amendments. Pub. L. No. 97-229, § 4(c), 96 Stat. 253 (1982).

[39] As enacted, §§ 201 and 203 also required the President to develop a "rationing contingency plan" as part of regulations promulgated under § 4(a) of the EPAA, 15 U.S.C. § 753(a). *See* 42 U.S.C. §§ 6261, 6263. This authority expired on September 30, 1981. *See id.* § 6263(f) (1976).

[40] For the reasons set forth *supra* at n.36, we believe that this two-House approval provision is within the class of so-called legislative veto mechanisms that violate the requirements of Art. I, § 7 of the Constitution and the principle of separation of powers.

As described more fully in Part II below, under the allocation provisions of the IEP, when a reduction in oil supplies reaches the "trigger" level, the United States may have an obligation to allocate oil to another Participating Country, or may have the right to receive allocations of oil from another Participating Country, depending on calculation of the United States' "supply rights." Chapter III of the IEP Agreement provides that "when the sum of normal domestic production and actual net imports available during an emergency exceeds its supply right [the country] shall have an allocation obligation which requires it to supply, directly or indirectly, the quantity of oil equal to that excess to other Participating Countries." Chapter III obligates the United States and the IEP countries to take "necessary measures" to ensure that such allocation will be carried out. As provided in Chapter IV of the Agreement, there are two types of emergencies that "trigger" or activate a nation's allocation obligations under the IEP Agreement: (1) a selective trigger, which occurs when one or more Participating Countries suffer a 7% or greater shortfall of available supplies measured against final oil consumption during a specified base period; and (2) a general trigger, which occurs when the Participating Countries as a whole suffer a 7% or greater shortfall.[41]

The IEP Agreement also provides for the furnishing of information to the International Energy Agency ("IEA")[42] during normal and emergency situations. Pursuant to Chapter V, Participating Countries are required to supply to the IEA certain information concerning the international oil market and activities of oil companies, and the possible development of oil shortages, and are responsible for assuring that oil companies subject to their jurisdiction provide them with the required information.[43]

a. Section 251. International Allocation

Section 251 of the EPCA, 42 U.S.C. § 6271, provides the exclusive statutory authority for the President to require U.S. oil companies to allocate petroleum products to Participating

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[41] See *infra* at 55-56.

[42] The IEA is the international body set up by the IEP Agreement. The supreme decisionmaking body of the IEA is the Governing Board, which includes a representative of each member government. A permanent staff is provided by the establishment of a Secretariat. Much of the work of the IEA is done by several "standing groups," consisting of senior personnel from the Participating Countries.

[43] The IEP information system is discussed *infra* at 55.

Countries, if such allocation is necessary for the purpose of implementing obligations of the United States under the IEP.[44] That section authorizes the President to promulgate rules requiring that producers, transporters, refiners, distributors, or storers of petroleum products "take such action as [the President] determines to be necessary for implementation of the obligations of the United States under Chapters III and IV of the [IEP] insofar as such obligations relate to the international allocation of petroleum products." The President's authority under that section specifically includes the authority to regulate the allocation and price of petroleum products owned or controlled by oil companies subject to the jurisdiction of the United States.[45] No rule promulgated under § 251 may be made effective unless (1) it has been transmitted to Congress, accompanied by a finding that implementation of the rule is required in order to fulfill the obligations of the United States under the IEP; (2) an "international energy supply emergency" has been declared by the President;[46] and (3) the IEP emergency system has been activated in accordance with the procedures and standards of Chapter IV.[47] No rule may remain in effect longer than twelve months after its transmittal to Congress. *Id.* § 6271(b).

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[44] Subsection (c)(2) of § 251, 42 U.S.C. § 6271(c)(2), makes clear that the authority is exclusive:

> No officer or agency of the United States shall have any authority, other than authority under this section, to require that petroleum products be allocated to other countries for the purpose of implementation of the obligations of the United States under the [IEP].

[45] Section 251(a), 42 U.S.C. § 6271(a), provides that "[a]llocation under such rule should be in such amounts and at such prices as are specified in (or determined in a manner provided by) such rule."

[46] An "international energy supply emergency" is defined by § 252(l)(1), 42 U.S.C. § 6272(l)(1), as:

> any period (A) beginning on any date which the President determines allocation of petroleum products to nations participating in the international energy program is required by chapters III and IV of such program, and (B) ending on a date on which he determines that such allocation is no longer required. Such a period may not exceed 90 days, but the President may establish one or more additional 90-day periods by making anew the determination under subparagraph (A) of the preceding sentence.

[47] The second and third requirements were recently added by the EEPA to clarify Congress's intent that § 251 does not provide authority for the President to implement allocation or price control requirements prior to activation of the IEP emergency system in accordance with Chapter IV of the Agreement. Pub. L. No. 97-229, § 2, 96 Stat. 248 (1982); see 128 Cong. Rec. S 6065 (daily ed. May 26, 1982) (remarks of Sen. McClure). This requirement would, for example, preclude use of § 251 to direct oil companies to allocate oil in "subcrisis" situations. A fuller discussion of this limitation is provided in Part II *infra*.

Under § 251, the President has clear authority to require oil companies subject to the jurisdiction of the United States to divert their oil supplies to other Participating Countries, and to determine prices at which such supplies should be sold, if a "trigger" situation has been declared in accordance with Chapter IV of the Agreement and if the President determines that such allocation is necessary to meet the United States' allocation obligations. A related question is whether § 251 provides the President with authority to allocate oil supplies among cooperating oil companies if those oil companies are disadvantaged by diversion of their projected supplies to other countries, when such diversion is necessary to enable the United States to meet its obligations under Chapters III and IV of the IEP Agreement. Although the IEP Agreement does not require that the United States have authority to control the allocation of price of oil domestically in order to ensure that those oil companies that assist the United States in meeting its obligations under the Agreement do not suffer competitively, the Agreement could arguably be interpreted to support the development of such a "fair share" domestic allocation program. Articles 6(1), 9(3) and 9(4) of the Agreement, for example, appear to contemplate that Participating Countries may implement such programs in order to fulfill their international allocation obligations.

> Art. 6(1). Each participating country shall take the necessary measures in order that allocation of oil will be carried out pursuant to [Chapter III] and Chapter IV.
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> * * * * *
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> Art. 9(3). Insofar as possible, normal channels of supply will be maintained as well as the normal supply proportions between crude oil and products and among different categories of crude oil and products.
>
> Art. 9(4). When allocation takes place, an objective of the Program shall be that available crude oil and products shall, insofar as possible, be shared within the refining and distributing industries as well as between refining and distributing companies in accordance with historical supply patterns.

Section 251 specifically authorizes the President to direct oil companies "to take such action as he determines to be necessary" to meet the international allocation obligations of the United States under the IEP. 42 U.S.C. § 6271(a). Consistent with this language and the arguable breadth of the IEP Agreement, the President could find that a limited domestic "fair sharing" allocation program would be necessary in order for the United States to meet its IEP allocation obligations through the voluntary cooperation of U.S. oil companies, because such cooperation could well depend on assurances to the participating companies that they would not suffer competitive losses. A presidential determination that such a system is "necessary" to meet those obligations would be accorded substantial deference by the courts. *See generally, e.g., Chicago & Southern Airlines* v. *Western S.S. Corp.*, 333 U.S. 103 (1943); *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936); 42 Op. A.G. 363, 370 (1968). Similarly, the President's determination with regard to the nature of the United States' international allocation obligations under the IEP and the measures to be used to meet those obligations would be accorded substantial deference. *See generally, e.g., Federal Energy Administration* v. *Algonquin SNG, Inc.*, 426 U.S. 548, 561 (1976). It is clear, however, that neither the IEP nor § 251 *requires* the President to develop or implement a domestic "fair sharing" allocation plan.

It is less clear that § 251 could be used to establish comprehensive nationwide allocation and price controls, for example, such as those provided under the EPAA, on the basis that such controls are "necessary" for implementation of the United States' international allocation obligations under the IEP. An allocation and pricing regulation of the breadth available under the EPAA would not, at least in the absence of particular facts, appear to be linked with sufficient directness to fulfillment of the United States' international allocation obligations to justify a presidential finding of necessity. However, any exercise of presidential discretion under § 251 will depend on the particular facts presented. *See generally Federal Energy Administration* v. *Algonquin SNG, Inc., supra*, 426 U.S. at 571.

b. Section 252. Antitrust Defense

Section 252 of the EPCA, 42 U.S.C. § 6272, authorizes persons engaged in the business of producing, transporting, refining, distributing, or storing petroleum products to develop voluntary agreements and plans of action to facilitate or implement the United States' allocation and information obligations under the IEP, and establishes procedures for development of such agreements and plans and for approval and monitoring by federal officials.[48] That section provides a limited antitrust defense with respect to actions taken by participating companies in developing or implementing agreements that meet the requirements of the section. The antitrust defense is available only if the actions are taken in the course of developing or carrying out a voluntary agreement or plan of action, are in compliance with the requirements of the section and any rules promulgated thereunder, and are not taken for the purpose of injuring competition. Section 252(f)(2), 42 U.S.C. § 7272(f)(2), provides that actions taken to implement a voluntary agreement or plan of action must be "specified in, or within the reasonable contemplation of, an approved plan of action" in order to qualify for the antitrust defense. *Id.* A separate breach of contract defense is also provided if the alleged breach "was caused predominantly by action taken during an international energy supply emergency or to carry out a voluntary agreement or plan of action authorized and approved in accordance with [§ 252]." *Id.* § 6272(k).

The authority in § 252 to develop and implement voluntary agreements or plans of actions and the parallel antitrust and breach-of-contract defenses may be relied upon only in support of the United States' allocation and information obligations under Chapters III, IV, and V of the IEP Agreement. Any doubt whether § 252 would authorize actions taken by oil companies that are not provided for by the allocation and information provisions of Chapters III, IV, or V of the IEP was dispelled by the EEPA, which amended § 252 to provide that:

> The authority granted by this section shall apply only to the development or carrying out of voluntary agreements and plans of action to implement chapters III, IV, and V of the international energy program.

Pub. L. No. 97-229, § 2(b), 96 Stat. 248 (1982). See discussion *infra* at 63-64.

The legislative history of § 252 makes clear that the antitrust defense was not intended to authorize voluntary agreements among the oil companies for the domestic allocation or pricing of oil supplies, even if the purpose of such allocation were to ease disruptions caused by international allocations necessary to meet the United States' IEP obligations. The report issued by the Senate Committee on the Judiciary states that, at the request of the Ford Administration and of Chairman Hart of the Subcommittee on Antitrust and Monopoly, the requirements of § 121 (the predecessor to § 252) were tailored and limited to specific actions with respect to the international allocation of petroleum and the information system of the IEP. The Report indicates that the defense was intentionally not extended to domestic activities of companies participating in voluntary agreements or plans under § 252. *See* S. Rep. No. 26, 94th Cong., 1st Sess. 43 (1975).

c. Section 254. Exchange of Information with the International Energy Agency

Section 254, 42 U.S.C. § 6274, contains procedures for the transmittal of information to the IEA by the United States Government. That section provides that the Secretary of State may transmit to the IEA information and data related to the energy industry that is required to be submitted under the terms of the IEP Agreement. 42 U.S.C. § 6274(a). To the extent feasible, trade secrets and commercial or financial information must be aggregated to avoid identification of sources before being reported to the IEA by the United States Government. *Id.* However, such information may be transmitted directly by the government without aggregation during an international energy supply emergency,[49] or if the President certifies that the IEA has adopted and is implementing security measures to protect against disclosure of the information to any person or foreign nation. *Id.* The President may withhold transmittal of any data or information if he determines that transmittal would prejudice competition, violate the antitrust laws, or be inconsistent with national security. *Id.* § 6274(b).

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[48] Section 252 calls upon the Secretary of Energy to prescribe rules governing, and provides detailed procedural requirements with respect to, meetings held to develop or carry out a voluntary agreement or plan of action. 42 U.S.C. § 6272(b), (c). *See* 10 C.F.R. Part 209. The Attorney General and the Federal Trade Commission ("FTC") are to participate in the development and execution of voluntary agreements and plans of actions, and the Attorney General must approve any voluntary agreement or plan of action prior to its implementation. 42 U.S.C. § 6272(d). The Attorney General and the FTC are also to monitor the development and execution of voluntary agreements and plans of action in order to "promote competition and to prevent anticompetitive practices and effects." *Id.* § 6272(e). A "Voluntary Agreement and Plan of Action to Implement the International Energy Program," administered by the Secretary of Energy, was approved in 1976. *See* 41 Fed. Reg. 13998 (Apr. 1, 1976). Twenty U.S. oil companies are now participating in that Agreement. On May 8, 1981, the Department of Energy published a revised draft Plan of Action in the Federal Register. 46 Fed. Reg. 26036 (May 8, 1981).

[49] This exception is limited, however, to information or data relating to the international allocation of petroleum products. 42 U.S.C. § 6274(a)(2)(B)(i).

If the confidentiality of information to be transmitted to the IEA is otherwise protected by statute, the Secretary of Energy, prior to giving the information to the State Department, must obtain concurrence in its release from the head of the department or agency authorized to collect or obtain the information. *Id.* § 6274(c).

B. Defense Production Act of 1950

The Defense Production Act of 1950 ("DPA"), 50 U.S.C. app. § 2061 *et seq.*, provides the President with additional discretionary authority that may be available in the event of a substantial shortfall in petroleum supplies. The DPA is not an "emergency" statute, in the sense that the authority provided in the statute may be used only if certain specified "emergency" conditions occur.[60] Rather, the President may use that authority to meet a variety of national defense and national defense preparedness needs, whether or not an "emergency" situation exists. As discussed above, however, our focus in this Memorandum is on statutory authorities that may be available to the President in the event of a future "petroleum emergency." Consequently, our discussion of the scope of the DPA is generally limited to how that statute could be used by the President to respond to such an emergency. Nothing in this discussion is intended to suggest that, subject of course to the requirements of each relevant provision,[61] the DPA may not be used in other contexts or in non-emergency situations.

The purpose of the DPA is to provide for the promotion of the national defense by assuring that adequate productive capacity and supply exist to meet national defense needs. With one exception,[62] exercise of authority provided by the DPA must be linked to the needs of the national defense or of national defense preparedness programs.[63] The President has broad discretion to determine what those needs are and how the DPA authorities may be used, consistent with the specific requirements of each provision of the statute.[64] *See generally* H.R. Rep. No. 2759, 81st Cong., 2d Sess. 4 (1950); S. Rep. No. 470, 82nd Cong., 1st Sess. 12 (1951). In particular, in his determination of what the national defense requires, it is clear that the President may consider, *inter alia*, the potential impact of severe shortages in petroleum supplies available to the United States. In the Energy Security Act ("ESA"), Pub. L. No. 96-294, § 102, 94 Stat. 617 (1980), Congress specifically designated energy as a "strategic and critical material" within the meaning of the DPA's Declaration of Policy,[65] and added language to that Declaration to emphasize that preparedness programs, as well as actions to expand productive capacity and supply in order to assure the availability of energy supplies, are linked to the national defense:

> In view of the present international situation and in order to provide for the national defense and national security, our mobilization effort continues to require some diversion of certain materials and facilities from civilian use to military and related purposes. It also requires the development of preparedness programs and the expansion of productive capacity and supply beyond the levels needed to meet the civilian demand, in order to reduce the time required for full mobilization in the event of an attack on the United States *or to respond to actions occurring outside of the United States which could result in the termination or reduction of the availability of strategic and critical materials, including energy, and which would adversely affect the national defense preparedness of the United States. In order to insure the national defense pre-*

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[60] One exception is § 710(e), 50 U.S.C. app. § 2160(e), which, as we discuss *infra*, authorizes employment of members of the Executive Reserve only "during periods of emergency." See *infra* at 35-36.

[61] *See id.*

[62] See discussion of § 101(c), 50 U.S.C. app. § 2071(c), *infra* at 27-31.

[63] The term "national defense" is defined by the Act to include "programs for military and atomic energy production or construction, military assistance to any foreign nation, stockpiling, space and directly related activity." 50 U.S.C. app. § 2152(d).

[64] As described below, the particular basis for exercise of authority under each of the relevant provisions of the DPA differs somewhat, although, with the exception of § 101(c), 50 U.S.C. app. § 2071(c) (see n.52), that exercise must be related to the national defense or national defense preparedness programs. Thus, the President has authority under § 101(a), 50 U.S.C. app. § 2071(a), to order the priority performance of contracts or allocate materials "to promote the national defense;" under § 708, 50 U.S.C. app. § 2158, the President may authorize voluntary agreements among private individuals and companies "upon finding that conditions exist which may pose a direct threat to the national defense or its preparedness programs;" the President may employ persons from the private sector without compensation under § 710(b), 50 U.S.C. app. § 2160(b), "in order to carry out the provisions of [the DPA];" and he may establish and train an Executive Reserve pursuant to § 710(e), 50 U.S.C. app. § 2160(e), for employment "in executive positions in Government during periods of emergency."

[65] *See* 50 U.S.C. app. § 2076.

> ***paredness which is essential to national security, it is also necessary and appropriate to assure domestic energy supplies for national defense needs.***

50 U.S.C. app. § 2062 (amendment emphasized). The Conference Report explained:

> The "Declaration of Policy" is amended to make it clear that it is necessary and appropriate, indeed essential, "to assure domestic energy supplies for national defense needs."

H.R. Rep. No. 1104, 96th Cong., 2d Sess. 187 (1980).[56]

Three provisions of the DPA provide the President with authority to respond to a substantial petroleum shortage: § 101, 50 U.S.C. app. § 2071, which authorizes the President to require the priority performance of contracts or orders and to direct allocation of materials, including petroleum products, in certain circumstances; § 708, 50 U.S.C. app. § 2158, which authorizes the President to approve certain voluntary agreements relating to preparedness for national emergencies and thereby to trigger an antitrust defense for persons or companies participating in such agreements; and § 710, 50 U.S.C. app. § 2160, which authorizes the President to employ "persons of outstanding experience and ability" to serve without compensation in advisory positions for purposes of assisting in carrying out the DPA and to establish an Executive Reserve to train private and governmental personnel for employment in executive positions in the government during periods of emergency.

1. Section 101(a). Priority Performance of Contracts and Allocation of Materials

Section 101(a) of the DPA, 50 U.S.C. app. § 2071(a), authorizes the President to require performance on a priority basis of contracts or orders that he deems "necessary or appropriate to promote the national defense," and to allocate materials and facilities "in such manner, upon such conditions and to such extent as he shall deem necessary or appropriate to promote the national defense."[57] The authority provided to the President under this section has been characterized by Congress as "broad and flexible." H.R. Rep. No. 2759, 81st Cong., 2d Sess. 4 (1950). Indeed, the House Report on the original version of the DPA noted that § 101(a) would authorize a wide range of actions to meet the national defense needs of the United States:

> [The powers granted under § 101(a)] would include the power to issue orders stopping or reducing the production of any item; orders to prohibit the use of a material for a particular purpose or for anything except a particular purpose; and orders to prohibit the accumulation of excessive inventories. [Section 101(a)] would authorize the President to require filling certain orders in preference to other orders, or requiring the acceptance and performance of particular orders.

Id.; *see also* H.R. Rep. No. 639, 82d Cong., 1st Sess. 21-22 (1951). The report of the Senate Committee on amendments added to the DPA in 1952 cautions, however, that the section should be used "only where necessary or appropriate to promote the national defense. [It] should not be used to accomplish purposes, however meritorious, which bear no relation to national defense." S. Rep. No. 1599, 82d Cong., 2d Sess. 7 (1952).

In a petroleum emergency, § 101(a) could give the President authority, *inter alia*, to require acceptance of and priority performance under contracts relating to the production, delivery, or refining of petroleum products or to allocate supplies of petroleum products, depending on the circumstances of the emergency.[58] Section 101(a) might also be used to facilitate petroleum transportation during an emergency, for example, by requiring pipelines, marine terminals, and other facilities to perform oil transport contracts necessary or appropriate to promote the national defense.

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[56] Congress intended that this amendment to the DPA make explicit the link between domestic energy supplies and the national defense, but it did not intend to grant any new allocation or pricing authority or new authority to engage in the production of energy (except as authorized by the ESA with respect to synthetic fuel production). *See* 50 U.S.C. app. § 2076:

[57] The full text of § 101(a) reads as follows:

> The President is hereby authorized (1) to require that performance under contracts or orders (other than contracts of employment) which he deems necessary or appropriate to promote the national defense shall take priority over performance under any other contract or order, and, for the purpose of assuring such priority, to require acceptance and performance of such contracts or orders in preference to other contracts or orders by any person he finds to be capable of their performance, and (2) to allocate materials and facilities in such manner, upon such conditions, and to such extent as he shall deem necessary or appropriate to promote the national defense.

50 U.S.C. app. § 2071(a).

[58] It is clear that Congress contemplated use of § 101(a), as well as other DPA provisions, to control the performance of petroleum-related contracts and to allocate petroleum products, if the President were to find such action

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The President's authority would be subject to certain limitations or would have to rest on certain findings required by the DPA. First, the requisite "national defense" nexus must exist. Use of the authority provided by § 101(a) specifically to respond to a petroleum emergency would have to be based on a presidential determination that the emergency threatens or adversely affects the national defense, as that term is defined in the Act.[59] However, as noted above, Congress has specifically recognized that national defense concerns may be implicated by a shortfall in energy supplies, particularly a shortfall resulting from actions occurring outside the United States. See *supra* at 21. Especially in light of this clear congressional intent, a presidential determination that a substantial reduction in petroleum supplies affects the national defense and security of the United States would be given considerable deference by the courts. *See generally Federal Energy Administration* v. *Algonquin SNG, Inc., supra*, 426 U.S. at 561.

Second, the President's authority is limited by § 101(b), 50 U.S.C. app. § 2071(b), which directs that the powers granted in § 101(a) can be used to control the general distribu-

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necessary and appropriate to promote the national defense. The 1950 House Report noted that increased demand for certain metals for the military and other programs or for stockpiling "will inevitably cut down on the supply available to industry generally, with consequent dislocations. The same situation is present, to a greater or lesser extent, in the case of many other materials, such as many chemicals, *petroleum*, and in the case of many kinds of equipment." H.R. Rep. No. 2759, 81st Cong., 2d Sess. 7 (1950) (emphasis added). Moreover, the definition of "materials" subject to the President's allocation authority ("raw materials, articles, commodities, products, supplies, components, technical information, and processes") is clearly broad enough to include petroleum products, especially in light of that legislative history. *See* 50 U.S.C. app. § 2152(b); H.R. Rep. No. 2759, *supra*, at 7. That interpretation is confirmed by the language and legislative history of the provision of the ESA that clarified that "energy" is a "strategic and critical material" within the meaning of the DPA's Declaration of Policy. See *supra* at 21.

[59] As we noted above, the President's authority under § 101(a) to direct priority performance of contracts or to allocate materials, including petroleum, is not necessarily dependent on the existence of a petroleum emergency. That authority could be used, for example, to require performance of petroleum supply, production, or transportation contracts or to allocate petroleum supplies on a timely basis, if necessary to meet the needs of a particular defense program, even if no "emergency" situation exists.

tion of material in civilian markets only if the President finds that the material is a "scarce and critical material essential to the national defense" and that defense needs cannot be met without causing dislocations in that market that will create "appreciable hardship." This section, which was added to the DPA in 1953, was intended to address situations in which defense needs cause a hardship in civilian markets by making large demands on a limited resource or limited production capacity. The House report discussing the 1953 amendment described the need and scope of this restriction:

> In the proposed extension of the priorities and allocation authority the committee has taken cognizance of the conditions which exist today and has proposed that the powers not be used to control the general distribution of any material in the civilian market except in special cases where otherwise, because of demands for national defense of a scarce and critical material, there would be a significant dislocation in the civilian market resulting in appreciable hardship. Nickel at present provides an excellent illustration of the need for authority to provide for equitable distribution of available civilian supplies. It is estimated that during 1953 the military, AEC, and stockpile will take more than one-half of the total supply. These requirements are so heavy as to make it necessary to apportion, as equitably as possible, the residual supply among civilian uses.

H.R. Rep. No. 516, 83d Cong., 1st Sess. 5 (1953).[60]

Thus, § 101(a) provides broader authority for the President to allocate scarce materials among defense agencies, contractors, or suppliers than to allocate supplies of materials among refiners or importers, wholesalers, retailers, and end-users in the civilian market. If there were a direct defense requirement for the material, the material could be allocated to defense agencies or programs or to their contractors upon a finding that such allocation is "necessary or appropriate" to meet those defense needs. A direct defense need could occur, for example, if the material were required by defense preparedness programs of the Department of Defense, the atomic energy programs of the Department of Energy, certain programs of the National Aeronautics and Space Administration, or by a contractor of those agencies. Use of § 101(a) would be justified, *inter alia*, if demand for the material exceeded available supply, if suppliers of a defense-related material were unwilling or unable to supply that material to the government or to defense contractors, or if such a material were otherwise unavailable in a timely fashion through ordinary commercial channels. To take one example, if, as a result of a national petroleum shortage, defense agencies or contractors could not obtain sufficient petroleum products in time to meet the needs of defense preparedness programs, § 101(a) could be used to require suppliers to provide adequate petroleum supplies without regard to their existing contractual commitments. The DPA would relieve the seller of any liability for breach of contract resulting from compliance with such an order. 50 U.S.C. app. § 2157.

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[60] Another provision of the DPA, § 701(c), 50 U.S.C. app. § 2151(c), further limits the President's authority to control the distribution of material in the civilian market. Section 701(c) provides:

> Whenever the President invokes the powers given him in this Act to allocate any material in the civilian market, he shall do so in such a manner as to make available, so far as practicable, for business and various segments thereof in the normal channel of distribution of such material, a fair share of the available civilian supply based, so far as practicable, on the share received by such business under normal conditions during a representative period preceding any future allocation of materials: *Provided*, That the President shall, in the allocation of materials in the civilian market, give due consideration to the needs of new concerns and newly acquired operations, undue hardships of individual businesses, and the needs of smaller concerns in an industry.

On the other hand, the President's authority could not be used to control general distribution in the civilian market unless he were to make the further findings required by § 101(b). Thus, in order to implement a general domestic allocation of petroleum products under § 101(a) in response to a shortage of petroleum supplies, the President would have to find that defense needs for petroleum will reduce supplies of petroleum available to the civilian markets to the point of causing "significant dislocation" and "appreciable hardship." *See* 50 U.S.C. app. § 2071(b).

Third, it is not entirely clear whether the allocation authority contained in § 101(a) gives the President authority to impose price controls. The language of that section, which allows the President to allocate materials and facilities "upon such conditions, and to such extent as he shall deem necessary or appropriate," appears broad enough to authorize price controls.[61] As

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[61] That language is included only in clause (2) of § 101(a), with respect to allocation of materials and facilities; it does not appear in the language (Continued)

a practical matter, the President could find that the allocation of materials, particularly from unwilling suppliers, could not be accomplished without some form of price controls. As we have noted before, that is the sort of presidential determination to which the courts will ordinarily defer. See *supra* at 17. We note, however, that there is legislative history that suggests Congress did not intend the authority contained in § 101(a) to include authority to impose mandatory price controls. As enacted in 1950, the DPA empowered the President to impose general wage and price controls. *See* Act of Sept. 8, 1950, ch. 932, Title IV, 64 Stat. 803 (1950). However, those provisions were allowed to expire in 1953. In renewing other provisions of the DPA at that time, Congress specifically stated that the wage and price control provisions were no longer necessary. *See* H.R. Rep. No. 516, 83d Cong., 1st Sess. 2-3, 10-13 (1953). Therefore, in the absence of specific authorization, it is possible that a court may conclude that the DPA does not empower the President to impose mandatory price controls on materials, including petroleum, allocated under § 101(a).[62] *Cf. American Federation of Labor* v. *Kahn*, 618 F.2d 784, 794-96 (D.C. Cir.), *cert. denied*, 443 U.S. 915 (1979). Absent a specific factual setting, it would be inappropriate to speculate further as to how this issue might be resolved in the courts.

Fourth, the President cannot use the allocation authority in § 101(a) to require rationing of gasoline among end-users. 50 U.S.C. app. § 2075.[63]

2. Section 101(c). Maximizing Domestic Energy Supplies

Section 101(c) of the DPA, 50 U.S.C. App. § 2071(c), provides that the President may require the allocation of, or the priority performance under, contracts or orders relating to

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of clause (1) authorizing the President to require acceptance of and priority performance under contracts and orders. *Compare* 50 U.S.C. app. § 2071 (a)(1) *with id.* § 2071(a)(2).

[62] This legislative history would not necessarily preclude some limited regulation respecting price, for example a requirement of non-discriminatory pricing.

[63] This restriction was added by § 108 of the ESA, *codified at* 50 U.S.C. app. § 2075, and provides "[n]othing in [the DPA] shall be construed to authorize the President to institute, without the approval of the Congress, a program for the rationing of gasoline among classes of end-users." Because the "approval" of Congress would, of necessity, take the form of plenary legislation, such authority would be derived from that legislation and not from § 101(a).

"supplies of materials and equipment in order to maximize domestic energy supplies," if he makes certain findings with respect to the need for the materials for either the exploration, production, refining, transportation, or conservation of energy supplies, or for the construction and maintenance of energy facilities.[64] The President's authority under § 101(c) may be exercised "[n]otwithstanding any other provision of this Act," and therefore is not subject to the "national defense" requirement of § 101(a) or the constraints imposed by § 101(b), 50 U.S.C. app. § 2071(a), (b). This section thus provides some authority for the President to allocate materials in the civilian market, or to require priority performance of contracts, that is not dependent on a national defense nexus or the findings required by § 101(b).

The legislative history of § 101(c) indicates that Congress's specific concern was with bottlenecks in the production and transportation of energy caused by shortages in critical equipment needed for the production and transportation of energy. Section 101(c) was added to the DPA in 1975 by § 104 of the EPCA. The Report of the Senate Committee on Interior and Insular Affairs on the Senate version of the bill discussed the purpose of that provision as follows:

> Section 105 [of the Senate bill] authorizes the President to allocate supplies of materials and equipment associated with the production of energy supplies to the extent necessary to maintain and increase the production and transport of fuels. . . . This provision was included in the title in an attempt to remedy critical shortages and misallocations of pipe, pumps, drilling rigs and roofbolts, which are currently plaguing energy producers.
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> The committee received the following testimony at a hearing on February 27, 1974, from the Deputy Director at FEO:
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> > Mr. Sawhill. Well, I think that we have impediments to our domestic production. We have impediments because of the lack of tubular steel that we talked about before. We have impediments because of the lack of drilling rigs in this country. In other words, no matter what the price is, there are only so many wells we can drill, because there are only so many rigs available and so much tubular steel available.

S. Rep. No. 26, 94th Cong., 1st Sess. 34 (1975). This legislative history clearly contemplates that § 101(c) could be used, in the event of a petroleum emergency, to maximize available energy supplies through reducing bottlenecks in the production and transportation of energy, for example, to facilitate delivery of equipment necessary for increased energy production.[65]

It is somewhat less clear whether Congress intended that § 101(c) be used to allocate supplies of energy sources, such as petroleum products. Section 101(c) uses the term "materials and equipment." As we have noted, the definition of "materials" contained in the DPA, 50 U.S.C. app. § 2152(b), includes petroleum products. See *supra* n.58. However, the language of the Senate Report quoted above seems to indicate that the Senate intended the section to encompass only supplies of hardware such as parts and equipment, as distinguished from energy sources such as crude oil, petroleum, coal, natural gas, or petrochemical feedstocks. The authority has been used to date only for that purpose—*i.e.*, to provide assistance to energy production or transportation projects in obtaining scarce equipment and supplies. *See, e.g.*, 10 C.F.R. Part 216.

There is legislative history, however, that supports the contrary conclusion that § 101(c) was intended to give the President some authority to allocate energy supplies, including petroleum products, if the requisite findings are made. Senator Randolph, one of the conference bill's floor managers, stated in his remarks introducing the bill on the floor of the Senate:

> Mr. President, the Energy Policy and Conservation Act deals with several matters affecting domestic energy supply availability in general. Some provisions of S. 622 address leasing practices on the Outer Continen-

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[64] The President must find: (1) that such supplies are "scarce, critical, and essential to maintain or further (i) exploration, production, refining, transportation, or (ii) the conservation of energy supplies, or (iii) for the construction and maintenance of energy facilities;" and (2) that "maintenance or furtherance of exploration, production, refining, transportation, or conservation of energy supplies or the construction and maintenance of energy facilities cannot reasonably be accomplished without exercising the authority specified in paragraph (1) of this subsection." 50 U.S.C. app. § 2071(c)(2).

[65] Because the authority under § 101(c) to require performance of contracts is limited to contracts or orders "relating to supplies of materials and equipment," 50 U.S.C. app. § 2071(c), it is questionable whether § 101(c) provides authority to require performance of service contracts. Thus, there is some doubt, for example, whether § 101(c) would support a requirement that a pipeline, marine terminal, or other facility provide transportation services.

> tal Shelf and other Federal lands, *as well as the availability of energy supplies and equipment for the production of domestic energy supplies.* For example, authority is provided to assure that roof bolts are available for use in the underground production of coal—a significant restraint on coal production during the oil embargo in the winter of 1973.

121 Cong. Rec. 41022 (Dec. 16, 1975) (emphasis added). Moreover, neither the language of the section nor the legislative history suggests that "materials" as used in § 101(c) should be defined more narrowly than "materials" as used in § 101(a) which, as noted above, includes energy sources such as crude oil and petroleum products. In fact, Congress's intent in placing this authority in the DPA rather than in the EPCA was to prevent the creation of two overlapping and possibly inconsistent statutory schemes. Senator Proxmire, the sponsor of the amendment to place the authority in § 101 of the DPA, explained its effect as follows:

> [The amendment] is offered to avoid a duplicate allocation mechanism, which could very well conflict with the priorities and allocations program provided for defense programs under [the DPA] . . . The effect, then, of the amendment which I have proposed is essentially to take our existing and working allocation system and to broaden it to include domestic energy supplies, while at the same time to provide the authority to reconcile different claims on a basis that will best serve the total national interest.

121 Cong. Rec. 9162 (April 7, 1975) (remarks of Sen. Proxmire).

Thus, although the issue is not free from doubt because of the somewhat conflicting legislative history, § 101(c) could possibly also be used by the President to allocate an energy source such as petroleum products. As a practical matter, however, the usefulness of that authority may be significantly limited by the requirement of § 101(c) that the allocation be necessary to "maximize domestic energy supplies."[66] The legislative history of the section suggests strongly that Congress's intent was to enable the President to take action to increase supplies of energy, not to distribute existing energy supplies. See *supra* at 28-29. While it is conceivable that in limited situations the allocation of petroleum products might serve to increase energy production,[67] it is unlikely that in the event of a severe petroleum shortage § 101(c) could be relied upon to institute a general allocation of scarce supplies of petroleum among oil companies, regions, or end-users.

3. Section 708. Voluntary Agreements

Section 708 of the DPA, 50 U.S.C. app. § 2158, provides a limited antitrust defense for persons who carry out voluntary agreements "to help provide for the defense of the United States through the development of preparedness programs and the expansion of productive capacity and supply beyond levels needed to meet essential civilian demand in the United States." The section empowers the President to authorize the making of such voluntary agreements when he finds that "conditions exist which may pose a direct threat to the national defense or its preparedness programs." 50 U.S.C. app. § 2158(c).[68] Persons or companies participating in approved voluntary agreements may claim an antitrust defense with respect to any act or omission taken in good faith in the course of developing

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[66] The authority to allocate materials under section 101(c) is also dependent on a finding that the materials are "scarce and critical." *See* 50 U.S.C. app. § 2071(c)(2). Absent a finding of scarcity, § 101(c) would not be available to allocate energy sources. In a petroleum interruption, it is likely that this finding could be made, but the availability of the authority would obviously depend on the facts of any particular situation.

[67] There may be some circumstances that would justify a presidential finding that allocation of petroleum products is necessary to "maximize energy supplies." For example, the allocation of petroleum supplies to utilities could be necessary to maximize production of electricity. Arguably, the allocation of petroleum products for use in energy exploration, production, or transportation, such as building or maintaining oil rigs and refineries, might serve to increase total energy production in times of a petroleum shortfall. Allocation to end-users who adopt stringent conservation measures could also arguably provide for the most efficient use of available supplies and therefore increase total supplies.

[68] The original DPA § 708, enacted in 1950 and patterned after the 1942 Small Business Mobilization Act, gave the President broad authority to convey antitrust immunity:

> (b) No act or omission to act pursuant to this Act, . . . if requested by the President pursuant to a voluntary agreement or program approved . . . [by him] and found by the President to be in the public interest as contributing to the national defense shall be within the prohibitions of the antitrust laws . . . .

There were few procedural restrictions on the exercise of this authority. Section 708 was substantially revised in 1975 in conjunction with legislative enactment of § 252 of the EPCA, 42 U.S.C. § 2172. The 1975 DPA amendments reduced the antitrust immunity to a defense, adopted the "good faith" requirement, and imposed procedural safeguards comparable to those contained in § 252 of the EPCA. See Pub. L. No. 94-152, § 3, 89 Stat. 810 (1975).

or carrying out such an agreement. *Id.* § 2158(j). No voluntary agreement may be approved unless the Attorney General finds that its purpose "may not reasonably be achieved through a voluntary agreement having less anticompetitive effects or without any voluntary agreement." *Id.* § 2158(f)(1).[69]

The purpose of voluntary agreements authorized by § 708 is specifically "to help provide for the defense of the United States through the development of preparedness programs and the expansion of productive capacity and supply beyond levels needed to meet essential civilian demand in the United States." 50 U.S.C. app. § 2158(c). Because of the scope of the President's authority under the DPA to determine the reach of the term "national defense" and the explicit congressional recognition of the importance of energy preparedness to the national defense (see *supra* at 21), § 708 could be used to authorize a broad range of voluntary agreements among oil companies or with others to plan for or deal with a substantial petroleum shortage that may impair the national defense or national defense preparedness,[70] and would make available an antitrust defense for actions taken to formulate or implement such agreements.

With respect to energy-related activities, however, the § 708(j) antitrust defense is available only for domestic activities taken to develop or carry out a voluntary agreement. Section 708A(o), 50 U.S.C. app. § 2158(a)(o), makes the antitrust defense unavailable for voluntary agreements to carry out the IEP[71] or to voluntary agreements which "in whole or in part" are in furtherance of a "treaty or executive agreement to which the United States is a party or to implement a program of international cooperation between the United States and one or more foreign countries." This precludes use of § 708 to implement any voluntary "fair sharing" program to meet IEP obligations,[72] or to fulfill international obligations such as NATO oil supply commitments and the United States-Israel oil supply agreement.

In order to qualify for the defense, the conduct in question must have been undertaken in good faith, and the persons claiming the defense must have acted in accordance with the statute, applicable regulations, and the applicable voluntary agreement. 50 U.S.C. app. § 2158(j). The procedures imposed on meetings to develop and carry out voluntary agreements under § 708 of the DPA are quite similar to those imposed by § 252 of the EPCA, 42 U.S.C. § 6272. Public notice must be given, and the public must be afforded an opportunity to participate (unless the meeting concerns classified matters, matters specifically exempted by statute from disclosure, or matters related to trade secrets and proprietary data); the meeting must be attended by a federal employee (and chaired by the President's delegate if the meeting is to develop a voluntary agreement) and must be monitored by representatives of the Attorney General and the FTC; if the meeting is to develop a voluntary agreement, records and verbatim transcripts must be kept. The President's delegate or the Attorney General (after consultation with the FTC) may terminate or modify an agreement. *Id.* § 2158(e). Unlike § 252, however, § 708 does not contain any specific provision for adoption of plans of action.

Section 708(d), 50 U.S.C. app. § 2158(d), provides for establishment of advisory committees to aid the President or his delegated officers in carrying out the purposes of the section. Such

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[69] The DPA requires the Attorney General, after consultation with the FTC, to approve rules for the development of voluntary agreements and any voluntary agreement itself. 50 U.S.C. app. § 2158(e), (f). An agreement may be developed only at meetings in which the Attorney General and an FTC representative participate, and the Attorney General and the FTC are required to monitor the implementation of any voluntary agreement. *Id.* § 2158(g). The Attorney General is granted the authority to terminate an agreement at any time. *Id.* § 2158(h). The Attorney General and the FTC are given access to all relevant information, and have rulemaking authority to carry out their responsibilities. *Id.* § 2158(h), (i). Finally, both the Attorney General and the FTC are required to conduct surveys of the competitive effects of voluntary agreements, and the Attorney General must submit reports to Congress on the administration of any operative agreements. *Id.* § 2158(k).

[70] The authority contained in § 708 has been used in the past to authorize cooperation and exchange of information relating to the impact of petroleum shortages on the national defense. A "Voluntary Agreement Related to the Supply of Petroleum to Friendly Foreign Nations" was approved by the Attorney General and entered into on June 26, 1951. It was superseded by the "Voluntary Agreement on Foreign Petroleum Supply" approved June 1, 1953. This Agreement, formed under the sponsorship of the Department of the Interior, remained in effect until 1976. The Agreement was activated in response to international events, including the nationalization of the Suez Canal, the 1967 Six Days War, and the 1973 Yom Kippur War.

[71] As discussed above, § 252 of the EPCA, 42 U.S.C. § 6272, provides the only statutory antitrust defense for industry activities pursuant to authorized voluntary agreements or plans of actions in support of the IEP. *See supra* at 17-19. Section 708A(o) was added to the DPA at the time the EPCA was enacted, apparently with the intent of limiting duplication in the scope of § 252 of the EPCA and the existing antitrust defense in the DPA. *See* 121 Cong. Rec. 36619 (Nov. 14, 1975) (remarks of Reps. Dingell and Ashley). The amendment also had the effect, however, of narrowing the scope of the existing DPA provision and of the original House bill, which had provided antitrust protection for international voluntary agreements beyond the IEP.

[72] See *supra* at 16-17.

committees would be subject to the provisions of the Federal Advisory Committee Act, 5 U.S.C. app. § 1 *et seq.*, and provisions of the Federal Energy Administration Act of 1974, 15 U.S.C. § 776. Section 708(d) further provides that "in all cases such advisory committees . . . shall include representatives of the public, and the meetings of such committees shall be open to the public." 50 U.S.C. app. § 2158(d).

4. Section 710. Employment of Persons from the Private Sector

Pursuant to § 710 of the DPA, 50 U.S.C. app. § 2160, the President may, subject to certain restrictions, authorize the training and employment of persons from the private sector in order to facilitate planning for and responding to energy emergencies. Two methods of facilitating such training and employment are authorized by this section. Subsection (b) permits the President to employ "persons of outstanding experience and ability" to serve without compensation in advisory positions for purposes of assisting in carrying out the purposes and provisions of the DPA. *Id.* § 2160(b). Subsection (e) authorizes the establishment and training of a "nucleus executive reserve" ("Executive Reserve") for employment during "periods of emergency." *Id.* § 2160(e). Use of these authorities to obtain advice and assistance from the private sector in planning for or responding to an emergency caused by a petroleum shortage raises two legal issues: (1) the circumstances under which these authorities can be used; and (2) the applicability of conflict-of-interest and antitrust laws and regulations.

a. Circumstances Governing Use of Employees

Persons serving without compensation under § 710(b), 50 U.S.C. app. § 2160(b) ("WOCs"), may be used as necessary and appropriate to carry out the provisions of the DPA. Their service is not limited to times of emergency, and WOCs can therefore be employed for a variety of preparedness tasks, such as assisting in planning, providing counsel and assistance in conducting exercises or seminars, or assisting state and local officials to develop emergency preparedness plans and programs. WOCs may be employed, however, only if the employing department or agency head certifies that he or she has been "unable to obtain a person with the qualifications necessary for the position on a full-time, salaried basis," and that the appointment is necessary and appropriate to carry out provisions of the

DPA. 50 U.S.C. app. § 2160(b)(1), (5). WOCs may be appointed only to advisory or consultative positions, except that they may be appointed to decisionmaking (but not policymaking) positions if they are found to possess outstanding experience and ability not obtainable on a full-time, salaried basis. *Id.* § 2160(b)(2).

Under subsection (e), 50 U.S.C. app. § 2160(e), persons from either the private sector or from within the federal government may be appointed to an Executive Reserve.[73] During "periods of emergency" those individuals may be employed by the government either as regular federal employees or as WOCs. *See* S. Rep. No. 696, 84th Cong., 1st Sess. 9 (1955). Employment of a Reservist as a WOC would, of course, be subject to the limitations imposed by subsection (b). However, employment of a Reservist as a regular full- or part-time federal employee would not be subject to the limitations contained in subsection (b) with respect to use of the individual in decisionmaking or policymaking positions or with respect to compensation,[74] and would not require the employing federal agency to find that no full-time federal employee is available and qualified to perform functions to be performed by the Reservist.

The major limitation on the President's authority to use the Executive Reserve is that Reservists can be employed by the government only "during periods of emergency." *See* 50 U.S.C. app. § 2160(e).[75] The DPA does not define what constitutes an "emergency" for purposes of activation of the Reserve.[76]

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[73] By executive order, the President has established a "National Defense Executive Reserve," which is composed of "persons selected from various segments of the civilian economy and from government for training for employment in executive positions in the Federal Government in the event of the occurrence of an emergency that requires such employment." Exec. Order 11,179, 3 C.F.R. 246 (1964-65), *as amended by* Exec. Order 12,148, 3 C.F.R. 412 (1979). In addition, the President has delegated authority to employ WOCs to heads of departments or agencies that exercise DPA functions. Exec. Order 10,647, 3 C.F.R. 282 (1954-58), *as amended by* Exec. Order 11,355, 3 C.F.R. 653 (1966-70), and Exec. Order 12,107, 3 C.F.R. 264 (1978).

[74] The only provision respecting compensation of Reservists is that members who are not full-time government employees may be allowed transportation and per diem payments for the purpose of participating in the Executive Reserve training program. In the absence of any further restriction, it appears that Reservists could be employed as full-time, part-time, temporary, or unsalaried government employees in times of emergency. The legislative history of subsection (e) supports this conclusion. See S. Rep. No. 696, 84th Cong., 1st Sess. 9 (1955).

[75] This limitation does not preclude participation by Reservists in orientation and training; it does, however, preclude participation in the type of pre-emergency preparedness tasks that may be performed by WOCs.

[76] No other provision of the DPA specifically limits the President's authority to "periods of emergency."

Section 710(e), however, must be read in light of the purpose of the DPA to protect and promote the national defense, as expressed in the Declaration of Policy. Subsection (e), authorizing the Executive Reserve, was added to the DPA in 1955. At the same time, the Declaration of Policy was amended to include a specific congressional finding that the nation's mobilization program requires the development of preparedness programs and the expansion of productive capacity and supply "in order to reduce the time required for full mobilization in the event of an attack on the United States." *See* S. Rep. No. 696, 84th Cong., 1st Sess. 9 (1955). The Senate Report draws a direct link between authorization of the Executive Reserve and the Declaration of Policy:

> This provision [now section 710(e)] supports the added emphasis placed on preparedness for a period of full mobilization in the Declaration of Policy.

Id. at 8. The legislative history of subsection (e) thus makes clear that establishment and training of the Reserve and employment of Reservists is specifically intended to further the national defense preparedness aims of the DPA.[77]

Therefore, activation of the Reserve would depend on the existence of an emergency that, in the language of the Declaration of Policy, "would adversely affect the national defense preparedness of the United States." 50 U.S.C. app. § 2062.[78]

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[77] When Congress intended to eliminate the requirement of a "national defense" nexus, as in § 101(c), 50 U.S.C. app. § 2071(c), it did so in express terms. See *supra* at 30. The absence of any such limitation in § 710(e) is further evidence that Congress did not intend that the Executive Reserve be used for purposes unrelated to the national defense. *See generally United States v. Rutherford*, 442 U.S. 544, 552 (1979); *KSK Jewelry Co. v. Chicago Sheraton Corp.*, 283 F.2d 8, 11 (7th Cir. 1960).

[78] Section 710(e) does not, however, expressly require the President to declare a national emergency in order to activate the Reserve. *See* 50 U.S.C. app. § 2160(e). Therefore, we believe use of the Reserve is not subject to the provisions of the National Emergencies Act ("NEA"), 50 U.S.C. § 1601 *et seq.* The legislative history of the NEA makes clear that use of authorities under the DPA, such as the Executive Reserve, is not subject to that Act. In testimony before the House Subcommittee on Administrative Law and Governmental Relations, Assistant Attorney General Scalia of the Office of Legal Counsel, noted that:

> [L]aws like the Defense Production Act of 1950, which do not require a Presidential declaration of emergency for their use, are not affected by this title [*i.e.*, Title I]—even though they may be referred to in a lay sense as "emergency" statutes.

Hearings before the Subcommittee on Administrative Law and Governmental Relations of the Committee on the Judiciary, House of Representatives, 94th Cong., 1st Sess. 91 (1975). That comment is repeated in both the House and (Continued)

Likewise, although Section 710 does not limit *in haec verba* the functions that can be performed by Executive Reservists in the event of activation, the inclusion of authority for the Executive Reserve in the DPA and the legislative history of that section make clear that those functions are limited to achievement of the national defense preparedness and response purposes of the DPA.

As discussed above, however, the DPA's Declaration of Policy expressly contemplates that disruptions in energy supplies may affect the national defense interests of the United States. See *supra* at 21. Therefore, the President has broad discretion, in the event of a disruption in petroleum supplies, to determine that an energy emergency exists that could threaten national security or national defense preparedness and that would therefore justify activation and use of the Executive Reserve to assist in meeting the emergency.

b. Conflict-of-Interest and Antitrust Restrictions

A second question is whether individuals who serve as WOCs or Executive Reservists would be subject to conflict-of-interest restrictions imposed by federal laws and regulations or to liability under the antitrust laws. We believe that WOCs and Executive Reservists would be subject to conflict-of-interest and antitrust restraints, but the nature of these restraints could differ depending on the circumstances of their government employment and the nature of their ties to private employers.

1) Conflict-of-Interest Restrictions

Applicability of federal conflict-of-interest restrictions to WOCs and Executive Reservists would depend on whether those individuals would be considered to be federal officers or employees within the meaning of applicable statutes and regulations. The Federal Personnel Manual ("FPM"), App. C., sets forth the principles for determining whether persons serving

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Senate reports. *See* H.R. Rep. No. 238, 94th Cong., 1st Sess. 5 (1975); S. Rep. No. 1168, 94th Cong., 2d Sess. 4 (1976). Although this language refers only to Title I of the NEA, which terminated existing emergencies, there is nothing in the legislative history to suggest that the DPA is subject to the procedural requirements imposed by Title II of the NEA with respect to the future use of emergency authorities. Rather, the Senate Report states that "[t]he provisions of Title II . . . are designed to insure congressional oversight of Presidential actions *pursuant to declarations of a national emergency authorized by an act of Congress* . . . . The legislation is directed solely to Presidential *declarations of emergency*." S. Rep. No. 1168, *supra*, at 4 (emphasis added).

the federal government on a temporary or intermittent basis are subject to the conflict-of-interest laws. Briefly, the FPM distinguishes between (1) persons "whose advice is obtained by an agency . . . because of [their] individual qualifications and who serve . . . in an independent capacity" and (2) persons who are asked "to present the views of nongovernmental organization[s] or group[s] which [they] represent, or for which [they are] in a position to speak." FPM, App. C at C-4. The former category of independent experts are deemed to be subject to the conflict-of-interest laws because their service to the government is expected to be impartial and free from outside influence or control. The latter category of private representatives, on the other hand, are not subject to the conflict-of-interest laws because it is expected that such persons would be influenced by the private groups that they have been chosen to represent.[79]

We believe that the language and legislative history of § 710 are clear that the purpose of employment of WOCs and Executive Reservists is to obtain independent assistance and advice from uniquely qualified individuals,[80] and that therefore those individuals would be considered to be federal employees subject to conflict-of-interest restrictions, when they are actually employed to provide such assistance and advice.[81] The scope of the conflict-of-interest restrictions applicable to a particular individual would depend, *inter alia*, on whether the individual

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[79] We have found that these *FPM* criteria are ordinarily the most useful standards to apply in determining whether particular persons are federal employees for purposes of the conflict-of-interest laws. There are, however, other factors that may be relevant to such a determination. For example, if a person performs a government function, receives a government salary, or is supervised directly by government employees, it is likely that he or she will be deemed a federal employee for other personnel purposes. *See* 5 U.S.C. § 2105(a), and *Lodge 1858, AFGE* v. *NASA*, 424 F. Supp. 186 (D.D.C. 1976).

[80] In fact, § 710 originally provided for an exemption from the federal conflict-of-interest laws for WOCs and Reservists, which demonstrates that Congress certainly contemplated that such individuals would be considered to be federal employees for purposes of the conflict-of-interest laws. When the federal conflict-of-interest laws were recodified in 1962, the recodification act made that exemption inapplicable. Pub. L. No. 87-849, § 2, 76 Stat. 1126 (1962).

[81] We do not believe that Executive Reservists would generally be considered officers or employees of the federal government during orientation or training for mobilization assignments, because they would not normally act or advise on any matters pending before a federal department or agency during such periods. If, however, the responsibilities of a Reservist during training or orientation included assistance or advice to a federal department or agency, the conflict-of-interest restrictions would probably apply, depending on the facts of the particular situation.

is a "special government employee"[82] and whether he or she receives compensation for his or her services.

Since WOCs or Reservists could be employed by any of several federal agencies, consistent with the scope of the DPA, it is impossible to summarize here all of the applicable conflict-of-interest statutes and agency conduct standards. We note, however, that 18 U.S.C. §§ 208 and 209 would be of particular concern to an individual who comes from private employment to serve the federal government on a temporary or intermittent basis as a WOC or Executive Reservist. Section 208 imposes criminal penalties on any government employee, including a special government employee, who participates personally and substantially for the government in a matter in which he, his spouse or minor child, or a partner or an organization by which he is employed, has an arrangement for future employment, or is negotiating concerning employment, has a financial interest. Under appropriate circumstances, government agencies may grant waivers of this prohibition. *See* 18 U.S.C. § 208(b). Section 209 imposes criminal penalties on any regular government employee who receives any salary, or contribution to or supplementation of a salary, from a private source as compensation for services as a government employee. *Id.* § 209.[83] Special government employees and employees serving without compensation are not prohibited by § 209 from accepting a salary from an outside source for performance of their government duties. *Id.* Apart from § 209, the standards of conduct of the employing agency may limit the receipt of gifts or certain things of value by individuals subject to the standards, if the source of the compensation has a business relationship with the agency. Those limitations may differ depending on whether the individual is a regular or special government employee.[84]

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[82] A "special government employee" is a federal employee or officer who serves for no more than 130 days during any period of 365 days, on a full-time or intermittent basis. *See generally* 18 U.S.C. § 202(a). Under federal personnel rules, an agency may not appoint an individual to serve as a special government employee unless "at the time of his original appointment" the agency's "best estimate" is that during the following 365-day period the services of the appointee will be needed for 130 days or less. *See FPM*, App. C.

[83] Section 209 also imposes criminal penalties on any organization or individual that makes any such contribution or supplementation. 18 U.S.C. § 209(a).

[84] For example, regulations of the Department of Energy prohibit regular employees from accepting fees, compensation, gifts, payment of expenses, or any other thing of monetary value if the circumstances "may result in, or

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Other provisions of the federal criminal code impose restrictions on the ability of government employees to assist private parties in matters involving the government,[65] and on former government employees representing others in matters that they worked on or were responsible for, while in the government.[66] Additional restrictions may be imposed by statutes that are specific to the employing agency. The Department of Energy Organization Act, for example, imposes requirements or restrictions on certain Department employees with respect to divestiture and disclosure of financial interests, reporting of pre- and post-government employment, and appearances before the Department after employment. *See* 42 U.S.C. §§ 7211-7216.

2) Antitrust Exposure

Individuals who serve as WOCs or Executive Reservists and their private employers would also be subject to the antitrust laws. It is likely that any individual called to government service as a WOC or as a regular federal employee would retain some ties with his or her former private employer, and would probably return to private employment upon completion of government service. In light of these dual public and private roles, actions taken by the individual while employed by the government might raise questions of antitrust liability for the individual and the employer.[67] Actions that may raise some question under the antitrust laws could include, for example:

(1) advice to government policymakers with respect to governmental actions to be taken in markets in which the individual's company is involved;

(2) decisions that affect particular energy markets;

(3) agreements as to what actions are to be taken by their private firms, particularly if those individuals implement such actions in their private capacities; or

(4) exchange between private industry executives of confidential industry information, gained pursuant to training activities or governmental responsibilities.

In general, antitrust liability attaches only to private conduct that has anticompetitive consequences. *See Parker* v. *Brown*, 317 U.S. 341 (1943); *Sea-Land Service, Inc.* v. *The Alaska Railroad*, 659 F.2d 243 (D.C. Cir. 1981), *cert. denied*, —— U.S. ——, 102 S.Ct. 1274 (1982). Thus, actions taken by a governmental official within the scope of his authority do not ordinarily give rise to antitrust concerns. On the other hand, actions of WOCs or Reservists that cause competitive harm could result in antitrust liability if such individuals are acting outside the scope of their governmental activity.[68]

C. Trade Expansion Act of 1962

The Trade Expansion Act of 1962 ("TEA"), 19 U.S.C. § 1801 *et seq.*, provides the President with certain authority with respect to imports of crude oil and petroleum products, which may be available in the event of a severe shortage of petroleum supplies. Section 232(b), 19 U.S.C. § 1862(b), provides that, upon an investigation and finding that a commodity is entering the country "in such quantities or under such circumstances as to threaten to impair the national security," the President "shall take such action, and for such time, as he deems necessary to adjust the imports of [the] article and its derivatives so that . . . imports [of the article] will not threaten to impair the national security."

Presidents have often exercised this authority to respond to emergencies of different types and their actions have usually been sustained by the courts. In recent decades, Presidents have invoked national security successfully to establish quotas

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create the appearance of, a conflict of interest." 10 C.F.R. § 1010.204(a). *See also* 1010.604 (special government employees). Regulations issued by the Office of Personnel Management require that agency standards of conduct contain a provision that prohibits regular employees from soliciting or accepting any compensation or other thing of value, subject to certain exceptions, from a person who:

(1) Has, or is seeking to obtain, contractual or other business or financial relations with his agency;

(2) Conducts operations or activities that are regulated by his agency; or

(3) Has interests that may be substantially affected by the performance or nonperformance of his official duty.

5 C.F.R. § 735.202.

[65] *See, e.g.*, 18 U.S.C. §§ 203, 205.

[66] *See, e.g.*, 18 U.S.C. § 207.

[67] In general, antitrust exposure would probably be greatest when individuals are actually employed by the government in policymaking or decision-making positions, because they would then be in a position to make or affect governmental decisions that may have an impact on a particular industry or employer. However, it is possible, though less likely, that antitrust liability could attach for particular actions taken in the course of training and orientation, for example, for an exchange with other industry personnel of confidential information gained during the training program.

[68] *Cf. Harlow* v. *Fitzgerald*, —— U.S. ——, 50 U.S.L.W. 4815 (June 24, 1982); *Butz* v. *Economou*, 438 U.S. 478 (1978); *Continental Ore Co.* v. *Union Carbide & Carbon Corp.*, 370 U.S. 690 (1962); *Alabama Power Co.* v. *Alabama Electric Cooperative, Inc.*, 394 F.2d 672 (5th Cir.), *cert. denied*, 393 U.S. 1000 (1968).

on volumes of imports, including oil,[89] to establish license-fee systems,[90] to limit imports from certain countries,[91] and to allocate oil imports exempt from import fees to certain refineries.[92]

The President's powers under § 232(b) have received a broad interpretation. The authority of the President to take "such action as he deems necessary" was broadly construed by the Supreme Court in *Federal Energy Administration* v. *Algonquin SNG, Inc.*, 426 U.S. 548 (1976), which upheld the President's power to impose license fees. Throughout its decision, the Court cited with approval those portions of the legislative history that support the widest reasonable interpretation of the President's authority, such as the statement that it included the power "to take whatever action he deems necessary to adopt imports [including the use of] tariffs, quotas; import taxes or other methods of import restrictions." 426 U.S. at 564; *see also id.* at 558, 561-69.

In *Algonquin*, however, the Supreme Court also expressed the caveat that its opinion applied only to measures with an "initial and direct" effect on petroleum imports and not necessarily to presidential action with a "remote" effect on imports. 426 U.S. at 571.[93] This caution suggests that a court might limit the President's broad flexibility under the TEA to regulate imports of crude oil or petroleum products to measures whose primary purpose and impact is confined to imported, rather than domestic, supplies of those products. It is possible, therefore, that an attempt to control directly the price of, or to allocate, petroleum products refined in the United States would be ruled invalid by the courts, at least if the impact of such controls on oil imports would be remote and indirect and if the impact on domestic supplies would be direct. In the absence of a particular factual situation, however, we cannot predict whether the courts would strike down such allocation or pricing regulation.

Exercise of authority under § 232(b) must be based on a finding that the imports "threaten to impair the national security." The statute provides some guidance with respect to that finding by listing a number of illustrative factors that may be taken into account, as follows:

> (1) domestic production needed for projected national defense requirements;
>
> (2) capacity of domestic industries to meet defense requirements;
>
> (3) existing and anticipated availabilities of the human resources, products, raw materials, and other supplies and services essential to the national defense;
>
> (4) requirements of growth of such industries and such supplies and services; and
>
> (5) the quantities, availabilities, character and use of imported articles as those affect such industries and the capacity of the United States to meet national security requirements.

19 U.S.C. § 1862(c).[94]

The legislative history of § 232(b) firmly establishes that increasing the domestic production of oil is a legitimate national security aim. *See, e.g.*, 104 Cong. Rec. 10542-43 (June 9, 1958) (remarks of Rep. Mills). Recent practice, tacitly approved by the Supreme Court in *Federal Energy Administration* v. *Algonquin SNG, Inc.*, *supra*, suggests that reducing the consumption of oil may similarly be a legitimate national security aim. Thus, it seems likely that a court would sustain a presidential finding that imports of crude oil and petroleum products "threaten to impair the national security," *see* 19 U.S.C. § 1862(b), and thereby uphold the use of § 232(b).

D. International Emergency Economic Powers Act

The International Emergency Economic Powers Act ("IEEPA"), 50 U.S.C. §§ 1701-1706, provides the President, in the event of a national emergency, with plenary control over property that is subject to U.S. jurisdiction and in which any foreign country or national thereof has an "interest." *See generally Dames & Moore* v. *Regan*, 453 U.S. 654, 675 (1981). If a petroleum shortage is sufficiently severe to invoke a presidentially declared national emergency, the IEEPA could be used to control supplies of petroleum products in which foreign countries or foreign nationals have an "interest."

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[89] Proclamation 3279, 24 Fed. Reg. 1781 (Mar. 12, 1959). This proclamation was issued pursuant to a predecessor statute.

[90] Proclamation 4210, 9 Weekly Comp. of Pres. Docs. 406 (Apr. 18, 1973).

[91] President Carter utilized this authority to prohibit imports from Iran. Proclamation 4702, 44 Fed. Reg. 65581 (Nov. 14, 1979).

[92] *See, e.g.*, *FEA* v. *Algonquin SNG, Inc.*, 426 U.S. 548, 570-71 (1976); *Pancoastal Petroleum Ltd.* v. *Udall*, 348 F.2d 805, 807 (D.C. Cir. 1965).

[93] This dictum later was relied upon by a federal district court to strike down the Gasoline Conservation Fee imposed by President Carter on the ground that the fee was beyond the scope of the authority conferred by § 232(b). *Independent Gasoline Marketers Council* v. *Duncan*, 492 F. Supp. 614, 616-18 (D.D.C. 1980). The court ruled that the measure was principally a conservation measure and only indirectly a restriction on imports, and thus not authorized by the TEA. The district court's decision has little, if any, precedential effect, because the appeal was dismissed as moot and the opinion vacated after the fee was repealed by Congress.

[94] The text and the legislative history of this provision state that these considerations are illustrative but not exclusive. *See* S. Rep. No. 1838, 85th Cong., 2d Sess. 11-12 (1958).

The key provision of the IEEPA is § 203, 50 U.S.C. § 1702, which states that the President may:

> (A) investigate, regulate, or prohibit—
>
> (i) any transactions in foreign exchange,
>
> (ii) transfers of credit or payments between, by, through, or to any banking institution, to the extent that such transfers or payments involve any interest of any foreign country or a national thereof,
>
> (iii) the importing or exporting of currency or securities; and
>
> (B) investigate, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest;
>
> by any person, or with respect to any property, subject to the jurisdiction of the United States.[95]

The reach of § 203 is limited by § 202, 50 U.S.C. § 1701, which provides that the President may use these authorities only to deal with an "unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States, if the President declares a national emergency with respect to such threat." Section 202 also requires that the President declare a new national emergency for each new threat before he may exercise the emergency powers. *Id.*

Section 204(a) of the IEEPA, 50 U.S.C. § 1703(a), provides that the President "in every possible instance, shall consult with the Congress before exercising any of the authorities granted by this chapter, and shall consult regularly with the Congress so long as such authorities are exercised." Section 204(b), 50 U.S.C. § 1703(b), requires that "[w]henever the President exercises any of the authorities granted by this chapter, he shall immediately transmit to the Congress a report specifying" the circumstances necessitating the exercise of his authority; the reasons that the circumstances constitute an unusual and extraordinary threat; the authorities to be exercised and the actions to be taken; the reasons that such actions are necessary; a list of foreign countries with respect to which such actions are to be taken; and the reasons for such decisions.[96]

The scope of the authority available under the IEEPA to respond to an energy emergency, assuming the requisite findings have been made, depends on the breadth the courts are willing to accord to the term "interest" as used in § 203, 50 U.S.C. § 1702, in the context of a future petroleum shortage. The IEEPA does not define the term "interest," but the legislative history of the statute notes that the authorities available to the President "should be sufficiently broad and flexible to enable the President to respond as appropriate and necessary to unforeseen contingencies." H.R. Rep. No. 459, 95th Cong., 1st Sess. 10 (1977). In addition, in cases decided under the TWEA (see *supra* n.95) the courts have interpreted the same language in § 5(b)(1) of that statute, 50 U.S.C. app. § 5(b)(1), broadly.[97] The primary substantive limitation on the President's emergency authority is that § 203 of the IEEPA may not be used to regulate wholly domestic transactions. The House Report states that:

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[95] This provision was taken almost verbatim from § 5(b) of the Trading with the Enemy Act ("TWEA"), 50 U.S.C. app. § 1 *et seq.*, which gave the President certain authorities "[d]uring time of war or during any other period of national emergency declared by the President." The IEEPA removed from the TWEA the President's authorities "during any other period of national emergency" and placed those authorities in § 203(a)(1) of the IEEPA, 50 U.S.C. § 1702(a)(1). The TWEA currently provides the President with authority "during time of war" that is identical in most respects to that available under the IEEPA, but also permits the President to exercise some additional powers not encompassed in the IEEPA, such as seizing and vesting of enemy property and control over wholly domestic economic transactions. *See* 50 U.S.C. app. § 5(b)(1); H.R. Rep. No. 459, 95th Cong., 1st Sess. 15 & n.22 (1977).

[96] There is no provision in the IEEPA for a legislative veto of the President's actions. However, the declaration of an emergency under the IEEPA would be subject to the NEA (see *supra* n.78), which provides, *inter alia*, that Congress has the authority to terminate by concurrent resolution any national emergencies declared after September 14, 1976. *See* 50 U.S.C. § 1622(c). For the reasons set forth in n.35 *supra*, we believe this legislative veto provision of the NEA is unconstitutional.

[97] *See, e.g., Heaton* v. *United States*, 353 F.2d 288, 291-92 (9th Cir. 1965), *cert. denied*, 384 U.S. 990 (1966); *United States* v. *Broverman*, 180 F. Supp. 631, 636 (S.D.N.Y. 1959).

> the scope of the authorities should be clearly limited to the regulation of international economic transactions. Therefore the bill does not include authorities more appropriately lodged in other legislation, such as authority to regulate purely domestic transactions or to respond to purely domestic circumstances . . . .

H.R. Rep. No. 459, *supra*, at 10-11; *see also* S. Rep. No. 466, 95th Cong., 1st Sess. 5 (1977).[98]

In light of this legislative history, we believe that the President would have broad discretion under the IEEPA to determine whether a foreign nation or national has an "interest" in property subject to U.S. jurisdiction, and, if so, whether any of the authority granted in § 203 should be exercised over that property, provided the President does not attempt to regulate transactions that are purely domestic in nature.

For example, the term "interest" would include, but not be limited to, contract rights of foreign countries or their nationals to acquire or control the disposition of property, such as contingent rights or royalty interests in petroleum products owned or controlled by a company subject to U.S. jurisdiction. In the event of an emergency meeting the requirements of § 202, 50 U.S.C. § 1701, the President would therefore have authority to regulate the use, transportation, and disposition of those petroleum products. The authority contained in § 203 of the IEEPA could also be used to regulate imports of petroleum products acquired from foreign nations or nationals. For example, in time of a national emergency, the IEEPA would give the President authority to require American companies and foreign entities they control[99] to ship petroleum products they acquire abroad to other nations.

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[98] The House Report specifically notes that the IEEPA would not grant the President the same authority to regulate purely domestic transactions as would be available in time of war under the TWEA, for example, regulation of the hoarding of gold by U.S. citizens or the extension of consumer credit by U.S. businesses. *See* H.R. Rep. No. 459, 95th Cong., 1st Sess. 15 & n.23 (1977).

[99] American corporations are clearly subject to the jurisdiction of the United States. *See Restatement (Second) of Foreign Relations Law of the United States*, §§ 27, 30 (1965). Foreign entities they control may also be, although they may be subject to the competing jurisdiction of the foreign country. In addition, § 203(a)(1)(B) permits the President to "regulate [or] direct and compel . . . [the] exercising [of] any right, power, or privilege with respect to . . . any [foreign] property . . . ." 50 U.S.C. § 1702 (a)(1)(B). This authorizes the President to require a U.S. company to exercise its control over foreign entities in the way the President directs, at least when the direction furthers the purposes of other regulations imposed under the IEEPA.

On the other hand, the authority would probably not extend to property within the United States that is wholly owned by a U.S. company or individual, because the effect of regulation of such property would most probably be considered to be "wholly domestic." For example, the authority granted the President in times of a national emergency under the IEEPA probably would not extend to authorization of domestic pricing or allocation regulation.

E. Emergency Energy Conservation Act of 1979

Title II of the Emergency Energy Conservation Act of 1979 ("EECA"), 42 U.S.C. § 8501 *et seq.*, provides the President with discretionary authority to impose energy demand restraint measures in certain emergency circumstances as defined in that Act or to meet IEP obligations. Section 211(a) of the EECA, 42 U.S.C. § 8511(a), authorizes the President to establish energy conservation targets for any energy source on a nationwide and state-by-state basis if the President determines that a "severe energy supply interruption" exists or is imminent,[100] or that such action is required in order to fulfill obligations of the United States under the IEP.[101] If such targets are set, the states are required to develop and submit to the Department of Energy plans to provide "for emergency reduction in the public and private use of each energy source" for which any emergency conservation target is in effect. *Id.* § 8512(a), (b). The President may find inadequate compliance with a target in a state and substitute a federal plan in that State. *Id.* § 8513 (b).[102]

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[100] The definition of the term "severe energy supply interruption" for the purposes of the EECA differs from the definition for purposes of the EPCA (see *supra* at 6). Section 202(1) of the EECA provides that a "severe energy supply interruption" includes a national supply shortage of motor fuel *or of any other energy source* caused by an "interruption" in energy, including, but not limited to, imported petroleum products, or by sabotage or an act of God. *See* 42 U.S.C. § 8502(1) (emphasis added). Section 3(8) of the EPCA limits the term to energy shortages resulting from an interruption in the supply of imported petroleum products, or from sabotage or an act of God. 42 U.S.C. § 6202(8).

[101] Section 202(2) of the EECA, 42 U.S.C. § 8502(2), incorporates by reference the definition of the term "international energy program" established by § 3(7) of the EPCA, 42 U.S.C. § 6202(7).

[102] The Secretary of Energy must approve a state plan unless he finds—

> (A) that, taken as a whole, the plan is not likely to achieve the emergency conservation target established for that State . . . for each energy sources involved,

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If national targets are established for energy sources under the discretionary authority of § 211(a), the President is required to make effective an emergency energy conservation plan for uses by the federal government. 42 U.S.C. § 8511(c).[105]

F. Export Administration Act of 1979

Under the Export Administration Act of 1979 ("EAA") 50 U.S.C. app. § 2401 *et seq.*, the President may impose controls on exports, including petroleum products and materials and technology necessary to produce petroleum products, in order, *inter alia*, to further the foreign policy interests of the United States, to protect the economy from a drain of scarce resources, or to obtain leverage against countries that aid terrorists. Section 7(a), 50 U.S.C. app. § 2406(a), authorizes the President to prohibit or curtail the export of any goods subject to the jurisdiction of the United States or exported by any person subject to the jurisdiction of the United States, in order to carry out the policies of the Act. These policies are broad enough to allow the President to restrict the export of petroleum products in response to a substantial shortage. In relevant part, the Statement of Policy contained in the Act provides:

> (2) It is the policy of the United States to use export controls only after full consideration of the impact on the economy of the United States and only to the extent necessary—
>
> * * *
>
> (B) to restrict the export of goods and technology where necessary to further significantly the foreign policy of the United States or to fulfill its declared international obligations; and
>
> (C) to restrict the export of goods where necessary to protect the domestic economy from the excessive drain of scarce materials and to reduce the serious inflationary impact of foreign demand.
>
> * * *
>
> (8) It is the policy of the United States to use export controls to encourage other countries to take immediate steps to prevent the use of their territories or resources to aid, encourage, or give sanctuary to those persons involved in directing, supporting, or participating in acts of international terrorism. To achieve this objective, the President shall make every reasonable effort to secure the removal or reduction of such assistance to international terrorists through international cooperation and agreement before resorting to the imposition of export controls.

Id. § 2402(2)(B) & (C), (8). The statute does not, however, contain any authority for the President to impose allocation or price controls with respect to domestically produced or refined crude oil and petroleum.

Section 7 of the EAA also places certain limitations on the export of domestically produced crude oil transported by pipeline over rights-of-way granted by the Trans-Alaska Pipeline Authorization Act, 42 U.S.C. § 1652, and on the export of refined petroleum products. *See* 50 U.S.C. app. § 2406(d), (e). In addition, petroleum products produced from the NPRs (*see supra* at n.38), oil and gas produced from the Outer Continental Shelf, and crude oil transported by pipeline over rights-of-way granted under § 28(u) of the Mineral Lands Leasing Act ("MLLA"), 30 U.S.C. § 185(u), are made subject, by separate statutes, to the requirements and provisions of the EAA.[106] Section 7(d)(3) of the EAA, 50 U.S.C. app. § 2406

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(B) that, taken as a whole, the plan is likely to impose an unreasonably disproportionate share of the burden of restrictions of energy use on any specific class of industry, business, or commercial enterprise, or any individual segment thereof,

(C) that the requirements of this subchapter regarding the plan have not been met, or

(D) that a measure is—

(i) inconsistent with any otherwise applicable Federal law (including any rule or regulation under such law),

(ii) an undue burden on interstate commerce, or

(iii) a tax, tariff, or user fee not authorized by State law.

42 U.S.C. § 8512(c).

[105] The Department of Energy has established procedures for the development, submission, and approval of state plans and the standby federal plan. 10 C.F.R. Part 477.

[106] Petroleum products from the NPRs, oil and gas from the Outer Continental Shelf, and crude oil transported over MLLA rights-of-way, are subject to all of the limitations and licensing requirements of the EAA, except for products that are either exchanged in similar quantities for convenience or increased efficiency of transportation with persons or the government of an adjacent foreign state, or that are temporarily exported for convenience or increased efficiency of transportation across parts of an adjacent foreign state. 10 U.S.C. § 7430(3); 43 U.S.C. § 1354(a); 30 U.S.C. § 185(u). The Outer Continental Shelf Lands Act also specifically provides that OCS oil or gas "exchanged or exported pursuant to an existing international agreement" is exempt from the export restrictions of the EAA. 43 U.S.C. § 1354(d). Before any crude oil from the NPRs or any product refined therefrom or crude oil subject to MLLA restrictions may be exported, the President must

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(d)(3), specifies that the export restrictions imposed by the Act or by other provisions of law do not apply to exports of oil pursuant to any bilateral international oil supply agreement entered into by the United States before June 25, 1979, or to any country pursuant to the IEP's oil sharing system. Under § 103(c) of the EPCA, 42 U.S.C. § 6212(c), the Export Administration Act may be used to implement restrictions on the export of energy sources, materials or equipment imposed under that section. See discussion *supra* at 7.

G. Other Statutory Authorities

1. Fuel Switching Authorities

In the event of a petroleum emergency, the President may be able to use authority under several statutes to require fuel switching in order to mitigate the effects of the shortage and reduce dislocations in energy supplies. Fuel switching encompasses two types of emergency authority: (1) authority to prohibit the burning of petroleum or other fuels; and (2) authority to assure access to supplies of alternate fuels by allocation or mandatory interconnections, and possibly to augment available supplies through increased production or curtailed exports.

The President is given the authority to prohibit the burning of particular fuels by power plants and major fuel-burning installations by two statutes. Section 607 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), 15 U.S.C. § 717z, authorizes the President to prohibit the burning of natural gas by any electric power plant or major fuel-burning installation. Exercise of this authority depends on a finding by the President of the existence or imminence of a severe natural gas emergency that will endanger the supply of natural gas for high-priority uses. Section 404(b) of the Powerplant and Industrial Fuel Use Act ("FUA"), 42 U.S.C. § 8301 *et seq.*, empowers the President to prohibit the use of petroleum or natural gas as a primary energy source by any electric power plant or major fuel-burning installation. Exercise of this authority requires a finding of a severe energy supply interruption, as that term is defined in the EPCA (see *supra* at 6). *See* 42 U.S.C. § 8374(b).

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find, in addition to the requirements imposed by the EAA, that such exports will not diminish the total quality or quantity of petroleum available to the United States and that such exports are in the national interest and are in accord with the EAA. 10 U.S.C. § 7430(e); 30 U.S.C. § 185(u).

In addition to prohibiting the use of a particular fuel during an emergency, the President would have the authority under various statutes to assist the recipients of prohibition orders in obtaining alternate fuel supplies. During severe energy supply interruptions as defined in the EPCA, the President could allocate and require the transportation of coal for the use of any electric power plant or major fuel-burning installation, pursuant to § 404(a) of the FUA, 42 U.S.C. § 8374(a). Section 202(c) of the Federal Power Act ("FPA"), 16 U.S.C. § 791a *et seq.*, would allow the Department of Energy to order the temporary interconnection of facilities, and such generation, delivery, interchange, transmission, or power wheeling of electric energy as in its judgment would best meet the emergency. *See* 16 U.S.C. § 824a(c). In addition, under § 210 of the FPA, 16 U.S.C. § 824i, the Federal Energy Regulatory Commission ("FERC") would have the authority to order the physical connection of a cogeneration facility, small power production facility, or transmission facilities of any electric utility with the facilities of any other electric utility, federal power marketing agency, geothermal power producer, qualifying small power producer, or cogenerator. Section 211 of the FPA, 16 U.S.C. § 824j, would authorize the FERC to order electric utilities to provide wheeling transmission services, including any necessary enlargement of transmission capacity, for any other electric utility, geothermal power producer, or federal power marketing agency.

Certain deliveries of natural gas could also be facilitated under the Natural Gas Act ("NGA"), 15 U.S.C. § 717 *et seq.* Section 7 of the NGA, 15 U.S.C. § 717f, authorizes the FERC to order a natural gas company to extend or establish transportation facilities to sell natural gas to local distributors. Pursuant to § 303 of the Natural Gas Policy Act ("NGPA"), 15 U.S.C. § 3351, the President may allocate supplies of natural gas during an emergency as defined by § 301 of the NGPA in order to assist in meeting natural gas requirements for high-priority users of natural gas; the definition of an emergency is the same as set forth under the PURPA, and excludes energy supply emergencies not involving a significant natural gas shortage. *See* 15 U.S.C. §§ 3361, 3363. Section 302 of the NGPA, 15 U.S.C. § 3362, provides that the President's authority to direct interstate pipelines or local distribution companies served by interstate pipelines to contract for the purchase of emergency supplies of gas is limited to an emergency as defined by § 301. Thus, the President's authority under the NGPA to require allocation of natural gas supplies directly to affected users is limited to natural gas emergencies. In the event of a petroleum shortage, that authority therefore would probably not be available, for example, to allocate supplies to users with a dual natural gas and petroleum capability, unless there were also a significant natural gas shortage.[165]

Finally, in addition to incremental production of crude oil or natural gas pursuant to § 106 of the EPCA, 42 U.S.C. § 6214 (see *supra* at 8-9), or export controls on supplies of energy imposed under § 7 of the EAA, 50 U.S.C. § 2406, or § 103 of the EPCA, 42 U.S.C. § 6212 (see *supra* at 48-50, 7-8), domestic energy supplies might also be increased by terminating any export authorizations granted under § 3 of the NGA, 15 U.S.C. § 717b, or § 202(e) of the FPA, 16 U.S.C. § 824a(e).

2. Miscellaneous Statutes

A number of other statutes provide the President with selective authority to affect the use or distribution of petroleum products or to take other measures to respond to a petroleum emergency, authority that may be available to respond to a petroleum shortage if the specific triggering requirements of each statute are met. Pursuant to § 36 of the MLLA, 30 U.S.C. § 192, the United States may demand that any royalty accruing to it under an oil or gas lease be paid in oil or gas. The Outer Continental Shelf Lands Act, 43 U.S.C. § 1331 *et seq.*, gives the United States the right of first refusal to purchase OCS oil at market prices during "time of war or when the President shall so prescribe." 43 U.S.C. § 1341(b). Other measures available to the President might include facilitating transportation of petroleum products in times of emergency;[166] modifying air pollution control requirements in times of an emergency to allow efficient use of available energy sources;[167] or providing technical assistance, funds and personnel to states or to foreign countries in order to minimize the effects of a petroleum shortage.[168]

II. Legal Bases for Specified Energy Preparedness Activities

Consistent with § 3 of the EEPA, this Part addresses how the statutory authorities outlined in Part I support the enumerated energy emergency preparedness activities of the United States. See *supra* n.2. Since no petroleum emergency is likely to be isolated in cause, effect, or remedy, any or all of the authorities described above may, in the appropriate circumstances, provide some basis for the President to respond in some fashion, directly or indirectly, to a particular crisis. In most petroleum emergencies it is likely that several different statutory authorities would be available to the President. The scope of this discussion is therefore necessarily limited to identifying the primary statutory authorities that provide a basis for the enumerated preparedness activities. Failure to mention other less directly applicable authorities should not be interpreted to suggest that the President could not use such authorities to respond to a particular state of facts, if the requirements of those statutes were met.

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[165] The allocation authority in § 101(a) of the DPA, 50 U.S.C. app. § 2071(a), could possibly be used in a petroleum emergency to allocate natural gas to defense agencies and contractors for defense needs. However, that authority could not be used to allocate natural gas supplies in the civilian market, in the event of a petroleum emergency, unless natural gas were also in short supply and necessary for the needs of national defense, as required by § 101(b), 50 U.S.C. app. § 2071(b). See *supra* at 24-25.

[166] Under the Interstate Commerce Act, as *amended*, 49 U.S.C. § 10101 *et seq.*, the Interstate Commerce Commission could authorize the entry of new motor carriers or water carriers into temporary service if they were needed to ensure movement of essential petroleum products, or could issue priority orders during an emergency situation for rail movement of commodities, including petroleum products. 49 U.S.C. §§ 10928, 11123. The Magnuson Act, 50 U.S.C. § 191 *et seq.*, authorizes the Secretary of Transportation to make rules and regulations governing the movement of any vessel within the territorial waters of the United States if the President declares a national

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emergency to exist by reason of actual or threatened war, insurrection or invasion, or disturbance or threatened disturbance in the international relations of the United States. 50 U.S.C. § 192.

[167] Section 110(f) of the Clean Air Act, 42 U.S.C. § 7410(f), permits the temporary modification of a state's air pollution control program upon a presidential finding of a severe national or regional energy emergency.

[168] Under the Disaster Relief Act of 1974, 42 U.S.C. § 5121 *et seq.*, upon finding that an emergency or major disaster exists, the President could direct any federal agency to utilize its available resources and personnel in support of state and local disaster assistance efforts. 42 U.S.C. §§ 5145, 5146. The Foreign Assistance Act of 1961 empowers the President to allow federal agencies to furnish services and commodities on an advance-of-funds or reimbursement basis to friendly countries and international organizations, and to waive certain regulations governing the making, performance, amendment, or modification of contracts and the expenditure of funds by the federal government, if he determines such action to be in furtherance of the purpose of the Act to "support or promote economic or political stability" through provision of foreign assistance. 22 U.S.C. §§ 2346, 2357, 2393.

A. Authority to Implement the IEP

The IEP Agreement, adopted in response to the 1973-74 oil embargo, provides a cooperative system designed to reduce the vulnerability of Participating Countries to future supply disruptions and to dependence on imported oil. The IEP was formally adopted by 16 countries in 1974.[109] It was provisionally entered into as an executive agreement by the President. 27 U.S.T. 1685, T.I.A.S. No. 8278 (Nov. 18, 1974). The United States, on January 9, 1976, gave its notification that, having complied with constitutional procedures by obtaining the necessary legislation, it consented to be bound by the Agreement.[110]

1. Obligations Imposed by the IEP Agreement

The IEP Agreement imposes four principal substantive obligations on Participating Countries as follows:

a. Emergency Reserves (Chapter I)

Each Participating Country must maintain emergency reserves equal to 90 days of net oil imports. This commitment may be satisfied by existing oil stocks, including stocks in tankers and pipelines, fuel switching capacity, or standby oil production, to the extent decided by the Governing Board, based on certain determinations and studies required by the Annex to the IEP Agreement.

b. Demand Restraint (Chapter II)

Each Participating Country must develop or have ready a contingent program of demand restraint measures that will enable it to reduce oil consumption, in the event of activation of the IEP's emergency system (see *infra* at 55-56).

c. Oil Sharing (Chapter III)

Each Participating Country is required to take necessary measures to carry out the international allocation of oil among Participating Countries if required by activation of the emergency system (see *infra* at 55-56). A complex formula provides for calculation of "supply rights" and "allocation rights and obligations" of Participating Countries. This calculation takes into account historic levels of consumption and actual domestic production and net imports available during an emergency, and assumes that each Participating Country will absorb some of the shortfall through the use of demand restraint measures and emergency reserves. See *infra* at ns. 112 & 113.

d. Information Exchange (Chapter V)

Participating Countries are required to provide or make available to the IEA certain information necessary for monitoring the international supply of petroleum and ensuring the efficient operation of the emergency system. The information system established by the IEP Agreement consists of two sections: (1) a general section, requiring the communication of non-proprietary information on the international oil market and activities of oil companies; and (2) a special section requiring submission of proprietary information necessary to implement emergency measures.[111] Each Participating Country is required to take appropriate measures to ensure that oil companies operating within its jurisdiction make such information available as is necessary to fulfill the information obligations of that member.

2. Activation of the IEP Emergency System

The core of the IEP is Chapter IV, which outlines the circumstances that trigger the IEP emergency system. The emergency system may be triggered when one or more Participating Countries sustains or is likely to sustain an oil supply shortfall of more than 7%, measured against final oil consumption during a specified base period. The IEP provides for both a "selective" and a "general" trigger. A selective trigger may be declared if one or more Participating Countries suffers a 7% or greater shortfall.[112] In the event of a selective trigger, countries "may meet their allocation obligations by any measure of their choosing, including demand restraint measures or the use of emergency reserves." A general trigger may be declared only if the Participating Countries as a whole suffer at least a 7% reduction in oil supplies. Declaration of a general trigger activates the supply rights and allocation rights and obligations of Participating Countries as calculated according to Chapter III, and does not allow the same flexibility to choose emergency measures that is permitted under a selective trigger.[113]

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[109] *See Digest of U.S. Practice in Int'l Law* 560 (1974). These countries were Austria, Belgium, Canada, Denmark, Ireland, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States, and West Germany. Greece, Iceland, New Zealand, Norway, and Portugal have since consented to be bound by the Agreement.

[110] *See Digest of U.S. Practice in Int'l Law* 650 (1975). The enabling legislation was contained in Title II of the EPCA, 42 U.S.C. §§ 6271-6275, enacted in 1975, Pub. L. No. 94-163, Title II, 89 Stat. 871 (1975).

[111] A critical feature of the special information system is submission by oil companies of certain proprietary information in Questionnaire A and by member governments in Questionnaire B. If there is reason to believe that a serious oil supply disruption may be developing that could reach the 7% trigger (see *infra* at 55-56), the Secretariat, following contact with the member governments, may request submission of these questionnaires by participating oil companies and by member governments. Each member government makes its own decision as to whether or how to allow oil companies to respond. In the United States, this would be accomplished by issuance of an antitrust clearance by the Secretary of Energy, with the concurrence of the Attorney General, pursuant to the regulations and the Voluntary Agreement implementing § 252.

Article 22 of Chapter IV of the IEP Agreement also provides that the Governing Board may decide, by unanimous vote, to "activate any appropriate emergency measure not provided for in this Agreement, if the situation so requires." [114]

2. Statutory Authority to Implement the IEP Agreement

To the extent that statutory authority is required for or relevant to implementation of the obligations of the United States under the IEP, that authority is provided primarily by the EPCA and Title II of the EECA.[115] We address here the scope of that authority with respect to the various obligations created by the IEP Agreement.

a. Emergency Reserves

Under Chapter I of the IEP Agreement, a Participating Country's emergency reserve obligation may be met, *inter alia*, by private stocks of petroleum products. We have been informed by the Department of Energy that the level of private stocks maintained by U.S. companies has been and is expected to be sufficient to meet that obligation. We note that certain provisions of the EPCA and other statutes give the President discretionary authority that could be used to establish or draw down petroleum product reserves, if the President were to determine that such actions would be appropriate under the IEP Agreement and met the conditions otherwise specified in those statutes. For example, the President has discretionary authority to implement an IPR (see *supra* at 11), and to use reserves in the SPR in fulfillment of "obligations of the United States under the international energy program" (see *supra* at 12). The IEP Agreement also provides that a Participating Country's emergency reserve obligation may be met by fuel switching authorities or standby oil production, to the extent decided by the Governing Board.[116] Other relevant statutory authorities may therefore include the fuel switching authority granted under various federal statutes,[117] and the authority under § 106 of the EPCA, 42 U.S.C. § 6214, and 10 U.S.C. § 7422(b), to accelerate production of crude oil and natural gas on federal and state lands or petroleum products from the NPRs.[118]

We wish to emphasize, however, that the President's authority under those statutes is discretionary, and that any action taken would have to be in accordance with the specific terms of those statutes. No statute requires the President to take particular actions, or to use particular reserves, in order to implement the emergency reserve obligation of the United States under Chapter I of the IEP Agreement.

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[112] A selective trigger may be initiated by a request from an affected country or countries to the Secretariat of the IEA. If the Secretariat makes a positive finding that a 7% shortfall exists or is imminent, activation occurs and emergency measures are implemented within 15 days, unless within 6 days after the Secretariat's finding the Governing Board, by a weighted majority vote, decides not to activate the system or to require only partial activation. If within 72 hours of the initial request the Secretariat does not make a positive finding, the country may request the Governing Board to consider the situation. The Governing Board must meet within 48 hours, and within an additional 48 hours must make its finding whether the requisite shortfall exists. If it does so find, it must decide whether to activate emergency measures. If a selective trigger is declared, the country requesting that action must absorb the first 7% of the shortfall. Once that country has absorbed that amount of the shortfall, it has an allocation right equal to the amount of the shortfall above 7%. The other Participating Countries share the obligation to satisfy this allocation right on the basis of their consumption during a specified base period.

[113] The procedure for activation of the general trigger is the same as for a selective trigger. See *supra* n.112. In the event of an overall 7% or greater shortfall, each Participating Country has a supply right equal to its base period final consumption, after deducting required demand restraint and emergency reserve drawdown amounts. If a country's supply right exceeds the sum of its available domestic production and net imports during an emergency, it has an allocation right that entitles it to additional net imports from the other Participating Countries equal to that excess. If a country's available domestic production and net imports during an emergency exceed its supply right, it has an allocation obligation that requires it to supply other Participating Countries, directly or indirectly, with a quantity of oil equal to that excess.

[114] The scope of Article 22 is subject to some debate. See *infra* n.133.

[115] Other statutes may also provide authority with respect to petroleum products and emergency preparedness activities that could be used by the President in connection with IEP activities if the particular requirements of those statutes are met. Those authorities are discussed below in connection with the authority for participation in "subsidiary" IEP activities. See *infra* at 60-64.

[116] We have been informed by the Department of Energy that the Governing Board has not yet taken action to determine the extent to which the emergency reserve commitment may be satisfied by oil stocks, fuel switching capacity, and stand-by production.

[117] See *supra* at 50-52.

[118] See *supra* at 8-9 & n.3.

b. Demand Restraint Measures

Statutory authority for establishment of a contingent demand restraint program as required by Chapter II of the IEP Agreement is available under §§ 201 and 202 of the EPCA, 42 U.S.C. §§ 6261 & 6262, providing for establishment and implementation of federal energy conservation contingency plans,[119] and Title II of the EECA, 42 U.S.C. § 8501 *et seq.*, directing the development of state energy conservation contingency plans.[120] These plans may be implemented upon a discretionary presidential finding that they are necessary "to fulfill obligations of the United States under the international energy program." [121] Demand restraint could also be accomplished or facilitated by restricting supplies of petroleum products through the TEA,[122] or by relying on market forces to dampen demand. In addition, the IEP Agreement allows a Participating Country to substitute reserves held in excess of its emergency reserve commitment for demand restraint measures.

c. Oil Sharing

Section 252 of the EPCA, 42 U.S.C. § 6172, allows domestic oil companies to participate in meeting the allocation obligations of the United States under the IEP by establishing a framework for cooperation and by providing an antitrust defense for actions taken in accordance with those plans.[123] If necessary, such voluntary actions may be supplemented by mandatory regulation under § 251, which provides the President with authority to take actions necessary to fulfill obligations of the United States under the allocation provisions of the IEP, as set forth in Chapters III and IV of the Agreement. As discussed above, the President's authority under § 251 encompasses the authority to require companies subject to the jurisdiction of the United States to divert oil supplies to other Participating Countries in satisfaction of the United States' allocation obligations, and to establish a domestic "fair sharing" program of allocation among oil suppliers as necessary to ensure successful implementation of the IEP emergency system.[124] The authority provided in §§ 251 and 252 with respect to fulfillment of allocation obligations of the United States is available only if the emergency system has been activated in accordance with the requirements of Chapter IV of the Agreement.[125]

d. Information Exchange

Sections 254 and 252 of the EPCA, 42 U.S.C. §§ 6274 & 6272, establish procedures by which the United States may meet its obligations to provide information to the IEA. Section 254 authorizes the Secretary of State to provide to the IEA information and data related to the energy industry that is required to be submitted under the IEP.[126] The provisions of § 252 governing cooperation among and the antitrust defense for domestic oil companies (see *supra* at 17-19), as implemented by the applicable regulations, Voluntary Agreement, and Plan of Action, govern the supplying by oil companies of information required under Chapter V of the IEP Agreement and the availability of the antitrust defense for such activities. As implemented, the antitrust defense generally covers participating U.S. company advice and consultations in IEA meetings and system tests. If confidential, proprietary data is to be furnished or exchanged prior to activation of the IEP emergency system, § 5(b)(2) of the current Voluntary Agreement requires the prior approval of the Secretary of Energy, after consultation with the Secretary of State, and the concurrence of the Attorney General, after consultation with the FTC.[127] When the emergency system has been activated, § 5(b)(3) of the Voluntary Agreement

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[119] See *supra* at 12-13.

[120] See *supra* at 47-48.

[121] See *supra* at 47.

[122] As with the President's authority with respect to emergency reserves (see *supra* at 57), implementation of such plans is a discretionary decision.

[123] See *supra* at 17-19.

[124] See *supra* at 16-17.

[125] See *infra* at 63-64.

[126] This information may include data supplied by oil companies to the Department of Energy for transmission to the IEA, or data collected by the Department of Energy pursuant to other statutory authority, such as the Energy Supply and Environmental Coordination Act, 15 U.S.C. § 796, and the Federal Energy Administration Act, 15 U.S.C. § 772. Such information may be transmitted by the Department of Energy to the Department of State, for transmission to the IEA upon certification by the Secretary of State that the information is required to be submitted under the IEP. *See* 42 U.S.C. § 6274(a), (d).

[127] Section 5(b)(2) of the current Voluntary Agreement (*see* 41 Fed. Reg. 14000 (Apr. 1, 1976)) requires the prior approval of the Secretary of Energy, with the concurrence of the Attorney General, for any transmittal or exchange of confidential or proprietary information or data by oil companies to the IEA or to each other. Company-specific (*i.e.*, disaggregated data) must be aggregated by the Department of Energy or the IEA prior to disclosure to others, unless the Secretary of Energy, after consultation with the Secretary of State and with the concurrence of the Attorney General, "has determined that such exchange or disclosure is necessary to develop, prepare, or test emergency allocation measures."

confers antitrust protection, without the need for further clearance, with respect to the provision or exchange of "such types of confidential or proprietary information as are reasonably required to implement" the Voluntary Agreement and approved plans of action.[128]

4. December 10, 1981 Decision of the Governing Board with Respect to Subcrisis Activities

On December 10, 1981, the Governing Board of the IEA adopted by unanimous vote a "Decision on Preparation for Future Supply Disruptions" outlining a basis for consultation among Participating Countries in the event of a so-called "subcrisis" situation—*i.e.*, a disruption in oil supplies short of the 7% trigger required to activate the emergency system. The preamble to the Decision reflects that it is based on the following considerations:

> —disruptions in oil supply which did not reach the 7% level required to trigger the emergency allocation system have recently caused and could again cause damage to Member country economies through sharp oil price increases;
>
> —IEA countries should be better prepared to contribute to preventing a disruption in oil supply from again resulting in sharply higher prices and severe economic damage;
>
> —allowing market forces to operate and strengthening them where possible will improve the balance between supply and demand and the distribution of oil in short supply;
>
> —supplementary action by governments may be necessary in those areas where market forces do not sufficiently counteract the adverse impact of supply disruptions;
>
> —when such action is determined to be necessary, it should be light-handed and flexible in responding to the specific situation at hand and at the same time be taken promptly and effectively; . . . .

The December 10, 1981 Decision provides for monitoring by the IEA of oil markets in order to assess the nature and probable impact of future supply disruptions;[129] requires the Participating Countries to consult with each other and with the Secretariat in the event of a "subcrisis" supply disruption in order to refine the Secretariat's assessment of the supply, demand, and stock situation; and provides that in the event of a "subcrisis" supply disruption the Governing Board will meet to decide what action, if any, is necessary to meet the situation. The Decision lists several illustrative measures that could be considered by the Board in that event, such as discouragement of abnormal spot market purchases or other undesirable purchases, lowered consumption, short-term fuel switching, high levels of indigenous production, changes in stocks and stock policies, and informal efforts to minimize and contain the effects of supply imbalances. The Decision specifically recognizes that "detailed methods of implementation [of any such measures] will be decided by governments in accordance with national law and the IEP, and could vary from country to country while aimed at achieving the overall result desired on an integrated basis." It specifies further that consultation with oil companies concerning any measures that might later be agreed to would be undertaken by the governments having jurisdiction over those companies.

The United States voted in favor of the December 10, 1981 Decision and made the following statement explaining its interpretation of the effect of the Decision:

> The United States . . . welcomes this Decision. At the same time we must state for the record our understanding of it. The United States remains committed to reliance on free market forces as the most effective response to supply disruptions. We are pleased to note the inclusion of this thought in the preamble of the Decision as a guiding principle for IEA discussions of market disruptions. The Decision establishes a basis for future IEA consultations in the event of subtrigger supply disruptions. However, it does not commit IEA countries in advance as to the specific actions

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[128] The companies are required to notify the Department of Energy, the Attorney General, and the FTC of the types of information and data provided. The Secretary of Energy, after consultation with the Secretary of (Continued)

(Continued)
State, the Attorney General, and the FTC, may prescribe terms and conditions for the continued exchange or provision of information or data in an emergency situation. *See* 41 Fed. Reg. 14000 (Apr. 1, 1976).

[129] Specifically, the Decision states that the Executive Director of the IEA may, after consultations with Participating Countries, activate submission of Questionnaires A and B "consistent with procedures established for the emergency allocation system" in the event of a supply disruption.

which they might take in such circumstances. Moreover, we note the fact that any actions taken in response to future disruptions must be consistent with national law and the Agreement on an International Energy Program, and may vary from country to country.

As this statement recognizes, the December 10, 1981 Decision of the Governing Board does not impose any mandatory obligations on the United States or on any other Participating Country to take particular actions in a "subcrisis" situation. Rather, it provides only a requirement for future IEP consultations in the event of a "subcrisis" supply disruption.[180] The text of the Decision makes clear that it does not commit IEP countries in advance to particular actions they might take in responding to such situations. Therefore, the Decision itself has no independent legal significance, and presents no legal issue with respect to the President's authority to take steps to implement the Decision.

The December 10, 1981 Decision contemplates, however, that the Governing Board may decide on specific actions in the future, in the event of a particular "subcrisis" supply disruption. It is difficult to speculate as to what authority the President (or participating oil companies) would have to implement any future decision of the Governing Board in a "subcrisis" supply disruption, as that analysis would necessarily depend on the details of the action taken by the Governing Board. The December 10, 1981 Decision suggests that primary reliance would be placed on the operation of market forces to improve the supply/demand imbalance and to equalize the distribution of oil in short supply, and on informal, non-mandatory efforts by Participating Countries to strengthen those market forces. These efforts could include, for example, increased informal consultation among Participating Countries and between Participating Countries and oil companies subject to their jurisdiction, and public appeals by member governments for voluntary measures such as demand restraint, use of alternate fuels, increased indigenous production, and use of private reserve stocks. Implementation of informal measures such as these by the President would not require particular emergency statutory authority.[181]

Questions about the scope of the President's statutory authority and the authority of individuals and oil companies to cooperate voluntarily would arise if, in a "subcrisis" supply disruption, the Governing Board were to adopt mandatory measures requiring specific types of "supplementary action" by Participating Countries. *See* Preamble to December 10, 1981 Decision.[182] Presidential authority to implement a "subcrisis" decision of the Governing Board that imposes mandatory obligations may be available, depending on the circumstances, under certain of the statutory authorities described in Part I above.

However, a significant limitation on the President's authority to take action for the purpose of implementing allocation of oil supplies required by a "subcrisis" decision of the Governing Board, and on the ability of oil companies to cooperate voluntarily in such allocation, is imposed by §§ 251 and 252 of the EPCA, 42 U.S.C. §§ 6271 & 6272.[183] Under existing statutes, the President has no authority to direct allocation of petroleum products for the purpose of fulfilling allocation obligations imposed by the IEP, and oil companies have no antitrust defense with respect to voluntary actions to meet those allocation obligations, except as provided in §§ 251 and 252 of the EPCA. *See* 42 U.S.C. § 6271(c)(2);[134] *id.* § 6272(a).[135] As was made clear by the amendments to §§ 251 and 252 added in 1982 by the EEPA,[136] those sections do not apply to "subcrisis" activities, even if directed by the Governing Board pursuant to Article 22.[137] We believe Senator McClure's statements in debate on the amendatory provisions of the EEPA are dispositive on that point:

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[180] The Decision does contain provisions concerning the monitoring of oil markets by the Secretariat and activation of the Questionnaire A and B systems. These provisions, however, are specifically limited to the procedures established by the IEP Agreement, and therefore do not expand the existing obligations of Participating Countries under that Agreement.

[181] As we discuss *infra*, however, no statutory antitrust defense would be available for private individuals and companies with respect to voluntary actions taken in response to such efforts.

[182] Any such actions, if they purport to impose new or additional obligations on Participating Countries, would have to be taken by unanimous vote of the Governing Board. *See* Art. 61.1(b) (decisions which impose new obligations on Participating Countries that are not already specified in the Agreement must be by unanimous vote).

[183] This analysis assumes that the Governing Board could require some limited sharing of oil stocks or supplies in a "subcrisis" situation. We note, however, that a question exists whether the Governing Board could require any mandatory oil sharing in any supply disruption short of the 7% "trigger." The emergency measures provided for in the IEP Agreement, including mandatory demand restraint measures under Chapter II and allocation of oil under Chapter III, can be activated only "in accordance with [Chapter IV]." *See* Chap. IV, Art. 12. Article 22 of Chapter IV provides that the Governing Board may unanimously, at any time, "activate any appropriate emergency measures not provided for in the Agreement, if the situation so requires." It is debatable whether this general language in Article 22 allows the Governing Board to circumvent the carefully circumscribed and negotiated provisions of Chapters II, III, and IV, which link demand restraint obligations and allocation rights and obligations directly to the existence of a 7% shortfall in oil supplies of one or more Participating Countries. It is arguable that the reference in Article 22 to "appropriate emergency measures *not provided for in the Agreement*" (emphasis added) means that Article 22 contemplates emergency measures *other than* mandatory demand restraint and allocation requirements, which are already provided for in the Agreement.

> The argument has been made that article 22 confers authority on the IEA Governing Board to trigger an allocation system during a subcrisis situation, and that the section 252 antitrust defense would then be applicable to U.S. oil company participation in the allocation program. This argument is incorrect, section 252 would not apply in that situation.
>
> By amending sections 251 and 252 as I have proposed, we would hopefully avoid misinterpretations of those provisions by future administrations here in the United States, by other IEA countries, or by the IEA itself. We would thus insure that the authority conferred by sections 251 and 252 will apply only to crisis situations—those involving at least a 7 percent shortfall—in accordance with the intent of the Congress.

128 Cong. Rec. S 6065 (daily ed. May 26, 1982) (remarks of Sen. McClure). Thus, § 251 would provide no authority for the President to direct any allocation of oil for the purpose of implementing a Governing Board decision in a "subcrisis,"[138] and § 252 would provide no authority or antitrust defense for oil companies to participate in such an allocation.[139]

To the extent that any mandatory "subcrisis" measures adopted by the Governing Board would require the President to take particular implementing actions other than the allocation of oil, the President's authority would derive from existing statutory authorities other than §§ 251 and 252 of the EPCA. Such authorities may include, for example, other provisions of the EPCA and Title II of the EECA that may be used to fulfill the United States' "obligations under the [IEP]"—*i.e.*, §§ 151-161, 201-202, and 254 of the EPCA, 42 U.S.C. §§ 6231-6241, 6261-6262, 6274, and Title II of the EECA, 42 U.S.C. § 8501 *et seq.*[140]

Additional authority might be available under other statutory authorities described in Part I above, if domestic circumstances were to provide an adequate basis for use of those authorities. For example, an international disruption in the supply of petroleum products may result in an interruption in the supply of imported petroleum products in the United States of sufficient length and severity to trigger a "severe energy supply interruption." This would make available to the President, for example, the authority in § 106 of the EPCA, 42 U.S.C. § 6214, to require accelerated rates of production of crude oil on fields located on designated federal and state lands,[141] and the authority in § 404(b) of the FUA, 42 U.S.C. § 8374(b), to prohibit the use of natural gas or petroleum in power plants and other major fuel burning installations.[142]

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[134] "No officer or agency of the United States shall have any authority, other than authority under this section [*i.e.*, § 251], to require that petroleum products be allocated to other countries for the purpose of implementation of the obligations of the United States under the international energy program."

[135] "Effective 90 days after December 22, 1975, the requirements of this section [*i.e.*, § 252] shall be the sole procedures applicable to—

> (1) the development or carrying out of voluntary agreements and plans of action to implement the allocation and information provisions of the international energy program, and
>
> (2) the availability of immunity from the antitrust laws with respect to the development or carrying out of such voluntary agreements and plans of action."

[136] See supra at 18 & n.9.

[137] The United States, as a member of the Governing Board, would be able to veto any proposed decision that would require such allocation.

[138] In addition, the waiver provision in § 7(d)(3) of the EAA, 50 U.S.C. app. § 2406(d)(3), would not be available unless the IEP emergency system had been activated. See supra at 49-50.

[139] Section 252 also limits the availability of an antitrust defense with respect to the furnishing and exchange of information by oil companies pursuant to the provisions of Chapters IV and V of the Agreement.

[140] Arguably, a unanimous decision by the Governing Board requiring specific actions by Participating Countries would impose "obligations" on the United States "under the [IEP]" within the language of these provisions. Article 66 of the IEP Agreement provides that the Participating Countries "*shall take the necessary measures . . . to implement the Agreement and decisions taken by the Governing Board*" (emphasis added). In the absence of persuasive legislative history to the contrary or specific limiting language, such as exists with respect to §§ 251 and 252, the authority in §§ 151-161, 201-202, and 254 of the EPCA, and Title II of the EECA might be interpreted to extend to all "obligations" of the United States under the IEP, including mandatory measures required by a unanimous decision of the Governing Board. Whether decisions taken in this manner constitute IEP "obligations" within the meaning of those provisions, however, may be subject to some debate. Because of the unanimity required by Article 61.1(b), no such "obligations" could be imposed on the United States without its consent. Moreover, this conclusion could not apply to substantive amendments to the IEP Agreement after 1974, which are excluded from the definition of the IEP for purposes of the EPCA. See supra at n.23.

[141] See supra at 8-9.

Likewise, in the event of an international shortage in petroleum products that did not reach the "trigger" level, the President could determine that the shortage would affect the national defense preparedness of the United States and therefore use the authorities in the DPA relating to priority performance of contracts, allocation of materials and facilities, and activation of the Executive Reserve, in accordance with the specific requirements of those provisions.[143] In addition, a presidential declaration of an emergency under the IEEPA, if the circumstances of an international supply disruption met the threshold requirements established by that Act, would trigger presidential authority to control disposition of property in which a foreign country or national has an interest.[144]

However, the President could not use statutory allocation authority, for example, under the IEEPA, to require the international allocation of petroleum products among Participating Countries solely to implement a "subcrisis" decision of the Governing Board that requires Participating Countries to participate in an oil sharing plan.[145] In addition, no antitrust defense would be available under § 708 of the DPA for any voluntary international allocation made by oil companies to support implementation of such a "subcrisis" decision. *See* 50 U.S.C. app. § 2158(A)(o); 42 U.S.C. § 6272(a), discussed *supra* at 32-33.

5. National Emergency Sharing Organization

The term National Emergency Sharing Organization ("NESO") refers to the agency or entity within each IEP Participating Country that is responsible for general liaison with the IEA on matters of international oil allocation during an emergency and for national oil emergency matters. Authority for the President to establish a NESO or to provide that the functions of a NESO be performed by an existing agency or department within the government stems from 3 U.S.C. § 301 and congressional implementation of provisions of the IEP Agreement in the EPCA and the EECA. By executive order the President has designated the Department of Energy to function as the NESO for the United States. *See* Exec. Order 11,912, 3 C.F.R. 114 (1976), *as amended by* Exec. Order 12,038, 3 C.F.R. 136 (1978), *and* Exec. Order 12,156, 3 C.F.R. 427 (1979).

6. Emergency Sharing System

The "emergency sharing system" is a term that has been used to refer to those obligations as set forth in the IEP Agreement that may be triggered in the event of a 7% or greater shortfall in petroleum supplies of one or more Participating Countries. Authority for implementation by the United States of those obligations is discussed *supra* at 57-58.

7. Supply Rights Project

The supply rights project is a study being undertaken by the Department of Energy to determine what options, such as import quotas or tariffs, may be implemented to reduce or eliminate the likelihood that the United States will incur an allocation obligation if the emergency system is triggered. The project is being conducted pursuant to functions delegated to the Department of Energy under the Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, and 3 U.S.C. § 301. *See* Exec. Order 11,912, *supra*.

B. Authority to Fulfill NATO Obligations

Pursuant to its obligations under the North Atlantic Treaty, 63 Stat. 2241, the United States may in some circumstances be obligated to participate in distribution of available oil supplies among members of the North Atlantic Treaty Organization ("NATO") to satisfy the defense needs of NATO during a petroleum shortage. Two organizations within NATO have responsibility with respect to petroleum emergencies: (1) the Petroleum Planning Committee, which has the task of developing plans for the distribution of available oil supplies among NATO members if there are supply shortages during times of crisis or war; and (2) the NATO Wartime Oil Organization, which is NATO's emergency petroleum organization.

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[142] See supra at 51.

[143] See supra at 20-42. The President could use the authority in § 101(c) of the DPA, 50 U.S.C. app. § 2071(c), to allocate materials and supplies in order to maximize energy production, without making the finding of a national defense nexus required by other sections of the Act.

[144] See supra at 43-47.

[145] This conclusion assumes that the sole purpose for the President's decision to order such allocation would be to implement a "subcrisis" decision by the Governing Board imposing mandatory oil sharing requirements, and that the allocation would therefore be "for the purpose of implementation of the obligations of the United States under the [IEP]," within the meaning of § 251(c)(2), 42 U.S.C. § 6171(c)(2), quoted *supra* at n.134. By the express terms of that section, the only statutory authority available to the President in those circumstances would be § 251, which, as noted above, provides no allocation authority in "subcrisis" situations. See *supra* at 63-64. However, factors taken into consideration by the IEP Governing Board in responding to a "subcrisis" situation may, of course, also be taken into account by the President in his determination whether or how to exercise statutory authorities other than § 251, such as the IEEPA, together with additional considerations, including the impact of the oil shortage on the security, foreign policy, and economy of the United States. *See, e.g.*, 50 U.S.C. § 1701. We therefore do not suggest that, if the Governing Board were to impose oil sharing obligations on Participating Countries in a "subcrisis" situation, the President could not, independent of that decision, exercise authority under the IEEPA to require the allocation of petroleum products, consistent with the specific terms of the IEEPA.

The primary statutory authorities that would allow the President to fulfill responsibilities to NATO countries include the DPA,[146] the IEEPA,[147] the TWEA,[148] and the Foreign Assistance Act of 1961.[149] Some limitation on the President's flexibility is imposed by export restrictions imposed by the EAA and other statutes, which limit the availability of waivers of restrictions on the export of crude oil pursuant to the North Atlantic Treaty.[150] No statutory antitrust or breach-of-contract defense is available for voluntary participation by U.S. oil companies in NATO oil planning or sharing activities.[151]

C. Authority with Respect to Development and Use of the SPR

The legal authorities with respect to establishment, filling, and drawdown of the SPR are discussed *supra* at 10-12.

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[146] See *supra* at 20-41.

[147] See *supra* at 43-47.

[148] See *supra* at n.96.

[149] See *supra* at n.108.

[150] The EAA provides for waiver of export controls on crude oil required by the Act or by other acts only for exports "pursuant to a bilateral international oil supply agreement entered into by the United States with such nation before June 25, 1979, or to any country pursuant to the International Emergency Oil Sharing Plan of the International Energy Agency," which would not include exports to fulfill NATO responsibilities. 50 U.S.C. app. § 2406(d(3). See *supra* at 50.

[151] See *supra* at 17-19, 33. Protection generally would be available, however, for actions by oil companies required by government orders under those Acts. *See, e.g.*, 50 U.S.C. app. § 2157 (no person shall be held liable for an act "resulting directly or indirectly from compliance" with orders issued pursuant to the DPA); 50 U.S.C. § 1702(a)(3) ("[n]o person shall be held liable in any court for or with respect to anything done or omitted in good faith in connection with the administration of, or pursuant to and in reliance on, [the IEEPA], or any regulation, instruction, or direction issued under [the IEEPA]"); 50 U.S.C. app. § 5(b)(3) (TWEA).

D. Authority for Government Incentives to Encourage Private Petroleum Product Stocks

No statutory authority currently exists that would authorize specific government incentives, such as federal subsidies, loan guarantees, tax credits, or the establishment of quasi-governmental corporations to purchase and hold stocks, to encourage build-up in private petroleum product stocks. Incentives for the build-up of such stocks may, of course, be provided as a matter of policy within statutory constraints, for example, by removing market disincentives for increases in private stocks. Voluntary agreements under the DPA could possibly be used, consistent with the requirements of that Act, to facilitate the building of private stocks if necessary to promote the national defense or national defense preparedness. Participants would receive a limited antitrust defense for their participation. See *supra* at 31-33.

E. Authority for Reactivation of the Executive Reserve

The legal authorities with respect to establishment and activation of the Executive Reserve are discussed *supra* at 34-41.

F. Authority for Coordination with State and Local Governments

In response to initiatives at the federal, state, and local levels, most of the states have taken action to facilitate planning for or responding to energy emergencies. Cooperation between state and local governments and federal agencies in planning for energy emergencies is specifically authorized by §§ 201 and 202 of the EPCA, 42 U.S.C. §§ 6261 & 6262, and by Title II of the EECA, 42 U.S.C. § 8501 *et seq.*

State energy emergency response statutes, regulations, and plans differ considerably in their scope and applicability. Powers available under state emergency statutes range from broad grants of authority to state governors under general state disaster acts[152] to specific provisions enumerating actions that may be taken in response to an energy emergency, such as establishment of allocation, rationing, distribution, and conservation plans,[183] and setting up of state agencies to implement those option plans. State energy emergency contingency plans developed by several states provide for a range of actions in the event of an energy emergency, including public information and education programs; incentives to increase local production of energy; allocation, rationing, and distribution programs; transportation conservation measures; electricity restraints; and restrictions on retail operations or gasoline purchases. The definition of an energy emergency sufficient to trigger implementation of such authorities also differs from state to state.[184]

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[152] *See, e.g.*, Alaska Stat. § 26.23.010 *et seq.* (1981); Ill. Rev. Stat. § 1101 *et seq.* (1981); Va. Code §§ 44-146.13-44-146.28 (1976).

The major legal issue we address here with respect to the establishment or implementation of state energy emergency responses is whether or under what circumstances a state law, regulation, or plan may be subject to challenge on the ground that it is preempted by federal law or is an undue burden on interstate commerce. This issue is particularly difficult to analyze in the abstract. There are no mechanical tests to determine if particular state legislation or regulation is impermissible. Resolution of that issue depends on a case-by-case comparison of the applicable federal and state provisions and programs, and an analysis of the effect of the competing state and federal regulation in a specific fact situation. Given the diversity of both federal and state authorities related to energy emergency preparedness, it is impossible here to do more than outline the general principles that should govern that analysis.

1. Preemption of State Laws and Regulations

Pursuant to the Supremacy Clause of the Constitution (Art. VI, cl. 2),[185] state laws or regulations may be invalid if they operate in the same field or regulate the same subjects as federal laws or regulations. The determination whether particular state laws or actions taken pursuant to those laws are preempted depends on the purpose and nature of federal regulation in that field and the interaction of state regulation with federal regulation. The underlying task is to determine whether Congress intended, in a particular instance, to preempt state regulation of the same subject matter. *See Malone* v. *White Motor Corp.*, 435 U.S. 497, 504 (1978); *Retail Clerks* v. *Schermerhorn*, 375 U.S. 96, 103 (1963).

Occasionally, Congress explicitly defines the extent to which a particular statute preempts state law. *See generally Jones* v. *Rath Packing Co.*, 430 U.S. 519, 530-31 (1977). Section 6(b) of the EPAA, for example, provided that a regulation or order issued under the Act "shall preempt any provision of any program for the allocation of crude oil, residual fuel oil, or any refined petroleum product established by any state or local government if such provision is in conflict with such regulation or any such order." 15 U.S.C. § 755(b) (1976) (expired Sept. 30, 1981). Another example may be found in § 526 of the EPCA, which provides that:

> No State law or State program in effect on [the date of enactment of this Act], or which may become effective thereafter, shall be superseded by any provision of subchapter I or II of this chapter or any rule, regulation, or order thereunder, except insofar as such State law or State program is in conflict with such provision, rule, regulation, or order.

42 U.S.C. § 6396.[186]

In most cases, however, preemption must be inferred. The general rule is that stated in *Florida Avocado Growers* v. *Paul*, 373 U.S. 132 (1963):

> The principle to be derived from our decisions is that federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that Congress has unmistakably so ordained.

373 U.S. at 142 (citation omitted). This test was reaffirmed in two of the Court's 1981 decisions. *See Commonwealth Edison*

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[183] *See, e.g.*, Cal. Public Resources Code §§ 25700-25706 (West 1977); Kan. Stat. Ann. §§ 74-6801-09 (1980); Md. Natural Resources Code Ann. § 11-103 (Supp. 1981); Tenn. Code Ann. §§ 58-2-101-58-2-132 (1980).

[184] *Compare* Hawaii Rev. Stat. Chap. 125C (1976) *with* Wash. Rev. Code § 43.21G (1972); Mont. Code Ann. § 90-4-301 *et seq.* (1979); and Tenn. Code Ann. §§ 58-2-101-58-2-132 (1980).

[185] "The Constitution, and the laws of the United States . . . ; and all Treaties . . . shall be the Supreme Law of the Land."

[186] Even under statutes such as the EPAA and the EPCA, in which Congress makes its intent express with respect to the scope of preemption, a further determination must be made on a case-by-case basis as to whether particular state regulation is "in conflict with" federal provisions. *See, e.g.*, *Mobil Oil Corp.* v. *Dubno*, 492 F. Supp. 1004 (D. Conn. 1980); *Atlantic Richfield Co.* v. *Tribbitt*, 399 A.2d 535, 545 (Del. Ch. 1977); *New York State Office of Parks & Recreation* v. *Vantage Petroleum Co.*, 431 N.Y.S.2d 779 (N.Y. Sup. Ct. 1980); *New England Petroleum Corp.* v. *County of Suffolk*, 383 N.Y.S.2d 405 (N.Y. App. Div. 1976).

v. *Montana*, 453 U.S. 609, 634 (1981); *Chicago & North Western Transportation Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 317 (1981). Preemption may be found if Congress has occupied an entire field of interstate commerce, leaving no room for state legislation;[157] if the state legislation "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress;"[158] or if state legislation is inconsistent with specific provisions of a federal statute or regulation.[159]

The clearest examples of state energy emergency laws or regulations that may be subject to challenge under the preemption doctrine would be laws or regulations that actually conflict with federal statutes or directives. For example, a state allocation regulation that requires an oil supplier to take actions inconsistent with effective federal allocation regulations implemented under the EPCA or the DPA would fall under the Supremacy Clause. A determination whether particular provisions of state emergency energy laws, regulations, or plans conflict with federal requirements can be made only by comparing these competing requirements. That comparison cannot be made in the abstract. The "relationship between state and federal laws" must be considered "as they are interpreted and applied, not merely as they are written." *Jones* v. *Rath Packing Co.*, *supra*, 430 U.S. at 526 (citations omitted). Since the scope and effect of both federal and state regulation in the event of an emergency will depend largely on the circumstances of that emergency and the choices made by the appropriate state and federal officials in response to that emergency, a determination whether particular state laws or regulations conflict with federal directives in all likelihood cannot be made unless and until an emergency exists and those authorities are exercised.

The basis for a preemption challenge to state laws or regulations would be more tenuous if the state enactment did not conflict directly with a particular federal directive, but rather conflicted only with a general federal policy. Recently, in *Commonwealth Edison Co.* v. *Montana*, *supra*, the Supreme Court conceded the power companies' point that the EPCA and the FUA were intended to encourage the use of coal. It nevertheless rejected their argument that this purpose preempted a severance tax imposed by Montana on coal mined on federal land, saying:

> [w]e do not accept appellants' implicit suggestion that these general statements demonstrate a congressional intent to preempt all state legislation that may have an adverse impact on the use of coal . . . . In cases such as this, it is necessary to look beyond general expressions of 'national policy' to specific federal statutes with which the state law is claimed to conflict.

453 U.S. at 633-34 (citations omitted).[160] Particularly if the state statute is "an exercise of 'historic police power of the states,'" which would include most state energy emergency laws and regulations, the Supreme Court has refused to find preemption "unless that was the 'clear and manifest purpose of Congress.'" *Florida Avocado Growers*, *supra*, 373 U.S. at 146, *quoting Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). The congressional mandate must be "unambiguous," *Florida Avocado Growers*, *supra*, 373 U.S. at 147, and "compelling." *New York Telephone Co.* v. *New York Labor Department*, 440 U.S. 519, 540 (1979).

In the absence of a relatively direct conflict between state and federal directives, we believe the statutory authorities available to the President to deal with an energy emergency probably would not be interpreted to contain an "unambiguous" and "compelling" mandate to preempt state energy emergency provisions. State laws or regulations are most likely to be vulnerable to a preemption challenge under either the EPCA or the DPA.[161] As noted above, the EPCA specifically saves from preemption all state laws and regulations except those that are in conflict with federal directives. Although the DPA does not contain a comparable savings provision, the breadth of the authorities available to the President under the DPA belies any argument that Congress intended to "occupy the field." The standby authorities provided in the DPA could be invoked in practically any area of the economy, and therefore it is highly unlikely that Congress intended that the states could not act at all in this broad area merely because the President was given broad but discretionary powers under the DPA. That conclusion, however, will depend ultimately on the facts of a particular situation.

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[157] *See, e.g.*, *Campbell* v. *Hussey*, 368 U.S. 297 (1961).

[158] *See Hines* v. *Davidowitz*, 312 U.S. 52, 67-68 (1941).

[159] *See, e.g.*, *Jones* v. *Rath Packing Co.*, 430 U.S. 519 (1977); *Warren Trading Post Co.* v. *Arizona Tax Commission*, 380 U.S. 685 (1965).

[160] However, a particular statutory scheme and legislative history could demonstrate that Congress intended to establish uniform national standards or regulations that would foreclose different or more stringent state requirements. In that event, state regulation would fail, even if no direct conflict existed between state and federal requirements. *See, e.g.*, *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151, 163-64 (1978).

[161] Most of the other statutory authorities, as described in Part I, deal with subjects that are generally outside the scope of a state's authority to regulate, such as exports and imports. *See, e.g.*, § 232 of the TEA, 19 U.S.C. § 1862 (*supra* at 41-43); § 203 of the IEEPA, 50 U.S.C. § 1702 (*supra* at 43-47); § 7(a) of the EAA, 50 U.S.C. app. § 2406(a) (*supra* at 48-50). It is possible, of course, that a particular situation may present a preemption question under statutory authorities other than the EPCA or the DPA.

2. Burden on Interstate Commerce

A separate question is whether or under what circumstances state laws, regulations, or plans may be subject to challenge under the "negative implication" of the Commerce Clause of the Constitution (Art. I, § 8, cl. 2).[102] Even in the absence of federal regulation, a state law or regulation may be unconstitutional because it creates an undue burden on interstate commerce. *See, e.g., Hughes* v. *Oklahoma*, 441 U.S. 322 (1979). However, not all state actions that regulate aspects of interstate commerce are unconstitutional. Determining the validity of particular state statutes or regulations that may affect interstate commerce requires a careful inquiry:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Pike v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) (citation omitted).

Although this inquiry necessarily depends on the particular facts presented, as a general matter state laws or regulations that would allow a state to enhance its petroleum supply to the detriment of other states, for example, by an allocation scheme or export restriction, would have to be carefully scrutinized. The Supreme Court has repeatedly struck down, as violative of the Commerce Clause, state statutes that "mandat[e] that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to the products derived therefrom." *New England Power Co.* v. *New Hampshire*, —— U.S. ——, 50 U.S.L.W. 4223, 4225 (Feb. 24, 1982), *citing Hughes* v. *Oklahoma*, *supra*, 441 U.S. 322 (1979); *Pennsylvania* v. *West Virginia*, 262 U.S. 553 (1923); *West* v. *Kansas Natural Gas Co.*, 221 U.S. 229 (1911); *Philadelphia* v. *New Jersey*, 437 U.S. 617, 627 (1978). Most recently, in *Sporhase* v. *Nebraska*, —— U.S. ——, 50 U.S.L.W. 5115 (July 2, 1982), the Court held unconstitutional a Nebraska statute conditioning export of ground water from the state on reciprocal treatment from the receiving state.

In *Sporhase*, however, the Court also suggested that not every restriction imposed by a state on the export of its natural resources is necessarily unconstitutional. The Court noted that:

> [A] State's power to regulate the use of water in times and places of shortage for the purpose of protecting the health of its citizens—and not simply the health of its economy—is at the core of its police power. For Commerce Clause purposes, we have long recognized a difference between economic protectionism, on the one hand, and health and safety regulation, on the other.

50 U.S.L.W. at 5119 (citation omitted). If the Nebraska statute in question had been "narrowly tailored to the conservation and preservation rationale," the Court indicated it might not have found a constitutional objection. *Id.* at 5120.[103] Therefore, it may be possible that a state could constitutionally impose some restrictions on the export or allocation of petroleum products to protect the health of its citizens in times of an emergency energy shortage if the restrictions were narrowly tailored to serve legitimate state preservation and conservation purposes. Any such statutes, however, would have to be subject to "the 'strictest scrutiny' reserved for facially discriminatory legislation." *Id.*, *quoting Hughes* v. *Oklahoma*, *supra*, 441 U.S. at 337.

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[102] "The Congress shall have the power . . . [t]o regulate commerce . . . among the several states."

[103] The scope of this potential exception to the Court's otherwise consistent holdings that a state may not constitutionally restrict its natural resources to its own citizens might conceivably be limited by the Court to restrictions on the export or use of water. In "balancing" the state's interests that might justify otherwise discriminatory legislation, the Court gave some weight to historic claims of state "ownership" of water within its borders. The Court made clear that such claims are based on a "legal fiction," but noted that they may be "more substantial than claims of public ownership of other natural resources." 50 U.S.L.W. at 5118, 5120. It is unclear, therefore, whether the narrow exception recognized by the Court would be extended to restrictions on other types of natural resources.

State laws or regulations that do not discriminate in favor of the state's own producers or consumers would not necessarily present the same facial constitutional objection, but may nonetheless be subject to challenge under the Commerce Clause. For example, if the regulation places unreasonable barriers to the flow of goods across state lines,[164] imposes price controls or other regulation directly on interstate transactions,[165] or poses a threat of multiple, inconsistent burdens because of similar, conflicting regulation by other states, it would be vulnerable to a constitutional challenge.[166] State measures designed to deal with energy emergencies that are strictly local in scope and effect and are clearly linked to preservation of the health and safety of the citizens of the state, would probably withstand constitutional scrutiny. A determination whether particular state laws or regulations would be vulnerable to challenge on the ground that they unconstitutionally burden interstate commerce can be made, however, only on a case-by-case basis.

G. Authority for Public Information Activities

A number of federal statutes charge the Department of Energy with specific responsibility and authority to gather and publish information relevant to energy supplies and energy emergency preparedness activities. *See, e.g.*, 42 U.S.C. § 6361 (b) (Secretary of Energy directed to develop a public education program to encourage energy conservation and efficiency); 15 U.S.C. §§ 772, 796 (Secretary of Energy authorized to request, acquire and collect energy information);[167] 42 U.S.C. § 7135 (establishment of Energy Information Administration); 42 U.S.C. § 8511(e) (Secretary of Energy directed to publish levels of consumption for targeted energy sources under the EECA). Other public information activities may be undertaken, on a formal or informal basis, in order to carry out functions delegated to the Department of Energy by statute or executive order. *See, e.g.*, 42 U.S.C. § 7101 *et seq.*; Exec. Order 12,038, 3 C.F.R. 136 (1978); Exec. Order 11,912, *supra*.

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[164] *See, e.g., Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 803 (1976).

[165] *See, e.g., Public Utilities Comm'n v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

[166] *See, e.g., Southern Pacific Co. v. Arizona*, 325 U.S. 761 (1945).

[167] Functions originally delegated under those provisions to the Administrator of the Federal Energy Administration have been transferred to the Secretary of Energy. *See* 42 U.S.C. § 7151(a).

III. Triggers for Exercise of Statutory Authorities

Section 272(a)(3)(B) the EPCA, as added by § 3 of the EEPA, provides that this Memorandum of Law should distinguish among three types of situations that could trigger a presidential exercise of authority to deal with a severe petroleum shortage, *viz*:

(i) situations involving limited or general war, international tensions that threaten national security, and other Presidentially declared emergencies;

(ii) events resulting in activation of the international energy program; and

(iii) events or situations less severe than those described in clauses (i) and (ii).

As described in Part I with respect to each statutory authority, the circumstances that provide a basis for exercise of a particular authority differ from statute to statute, and in some cases, among provisions of the same statute. Many of those circumstances overlap. In any particular emergency situation facts may justify action under a number of those statutes. Consequently, the President's authority cannot be subdivided neatly into the three categories listed, and an attempt to do so with any degree of certainty is inevitably somewhat misleading. Each statute must be considered on its own terms and in light of its legislative history and the facts of a given emergency. However, in order to comply fully with the intent of § 272(a), a rough categorization of the statutory authorities discussed in Part I is provided below. This categorization is not intended in any way to modify or add to the description of those authorities in Part I.

A. Situations Involving War, International Tensions That Threaten National Security, and Other Presidentially Declared Emeregncies

We have included, within the category of authorities that could be used in the enumerated factual situations, provisions that by their terms authorize the President to act in the interests of promoting the national defense and national security of the United States:[168]

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[168] Inclusion in this category of particular statutory authorities that do not, by their terms, require a presidential declaration of a national emer-

(Continued)

Defense Production Act, 50 U.S.C. app. §§ 2071(a) & (b), 2158, 2160
Trade Expansion Act, 19 U.S.C. § 1862
International Emergency Economic Powers Act, 50 U.S.C. § 1702
Trading with the Enemy Act, 50 U.S.C. app. § 5
Export Administration Act of 1979, 50 U.S.C. app. § 2406
Outer Continental Shelf Lands Act, 43 U.S.C. § 1341(b)
Magnuson Act, 50 U.S.C. § 192

B. Events Resulting in Activation of the International Energy Program

We construe the category described as "events resulting in activation of the International Energy Program" to encompass authorities that are expressly contingent on activation of the IEP emergency system in the event of a 7% oil shortage, in accordance with Chapter IV of the IEP Agreement. We do not include in this category other statutory authorities that may be relevant to participation by the United States in the IEP, but that do not necessarily depend on activation of the IEP emergency system:

Energy Policy and Conservation Act, 42 U.S.C. §§ 6271, 6272[159]

C. Less Severe Events or Situations

Included within this category are additional provisions that authorize presidential action in situations other than those necessarily involving the national defense or security, or requiring activation of the IEP emergency system:

Energy Policy and Conservation Act, 42 U.S.C. §§ 6212, 6214, 6231-6261, 6261-6262
Defense Production Act, 50 U.S.C. app. § 2071(c)
Emergency Energy Conservation Act, 42 U.S.C. § 8501 et seq.

(Continued)
gency, should not be construed to suggest that any such declaration would be a prerequisite for exercise of authority under that statute, or that exercise of that authority would be subject to the NEA. See supra at n.78.

[159] As described supra at 58-60, § 252, 42 U.S.C. § 6272, and the implementing regulations, Voluntary Agreement, and Plan of Action permit limited information exchange by companies prior to activation of the IEP emergency system.

Export Administration Act, 50 U.S.C. app. § 2406
Powerplant and Industrial Fuel Use Act, 42 U.S.C. § 8374(b)
Public Utility Regulatory Policies Act, 15 U.S.C. § 717z
Federal Power Act, 16 U.S.C. §§ 824a(c), 824i, 824j
Natural Gas Act, 15 U.S.C. §§ 717b, 717f
Natural Gas Policy Act, 15 U.S.C. §§ 3361, 3363
Mineral Lands Leasing Act, 30 U.S.C. § 192
Outer Continental Shelf Lands Act, 43 U.S.C. § 1341(b)
Interstate Commerce Act, 49 U.S.C. §§ 10922, 11128
Clean Air Act, 42 U.S.C. § 7410(f)
Disaster Relief Act, 42 U.S.C. §§ 5145, 5146
Foreign Assistance Act of 1961, 22 U.S.C. §§ 2346, 2357, 2393

IV. Conclusion

In conclusion, it is important to emphasize again that the discussion in this Memorandum of the statutory authorities that may be available to the President in the event of a petroleum emergency cannot possibly be exhaustive or entirely authoritative, because the nature and extent of that authority will necessarily differ depending on the factual situation presented by an actual petroleum shortage. Many of the legal issues raised with respect to the President's authority therefore cannot be fully resolved in the abstract. Within that significant constraint, we have attempted here to discuss as fully as possible each of the statutory authorities that we believe may be relevant in a future petroleum emergency, and to address specific legal issues raised by Congress during its consideration of § 3 of the EEPA. Consistent with the terms of that section, we hereby submit this Memorandum of Law, for transmission by the President to Congress.

THEODORE B. OLSON
Assistant Attorney General
Office of Legal Counsel

STATEMENT OF THE HONORABLE CAPTAIN WARREN G. LEBACK, MARITIME ADMINISTRATOR, DEPARTMENT OF TRANSPORTATION, BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS ON THE HANDLING OF JONES ACT WAIVERS TO ALLEVIATE THE FUEL CRISIS IN THE NORTHEAST.

JANUARY 16, 1990

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. MY NAME IS CAPTAIN WARREN G. LEBACK, AND I AM THE MARITIME ADMINISTRATOR, MARITIME ADMINISTRATION (MARAD) IN THE DEPARTMENT OF TRANSPORTATION. I AM HERE TODAY TO REVIEW MARAD's RESPONSIBILITIES IN THE ENFORCEMENT OF THE JONES ACT AND TO DESCRIBE RECENT ACTIONS OF THE AGENCY IN HANDLING WAIVER REQUESTS TO ALLOW THE USE OF FOREIGN VESSELS TO CARRY RESIDENTIAL HEATING FUELS FROM PUERTO RICO AND THE GULF TO THE U.S. EAST COAST.

THE DECLARATION OF POLICY CONTAINED IN SECTION 101 OF THE MERCHANT MARINE ACT OF 1936 DECLARES, AS RELEVANT TO THE DOMESTIC TRADES, THAT:

o A U.S. FLAG MERCHANT MARINE IS NECESSARY FOR THE NATIONAL DEFENSE AND DEVELOPMENT OF DOMESTIC COMMERCE. IT SHOULD BE:

a) SUFFICIENT TO CARRY OUR DOMESTIC WATERBORNE COMMERCE AND TO PROVIDE SHIPPING SERVICE ESSENTIAL TO MAINTAIN THE FLOW OF SUCH COMMERCE AT ALL TIMES.

b) ABLE TO SERVE AS A NAVAL OR MILITARY AUXILIARY IN WARTIME OR NATIONAL EMERGENCY.

c) OWNED AND OPERATED BY U.S. CITIZENS UNDER U. S.-FLAG.

d) COMPOSED OF U.S.-BUILT AND U.S. CITIZEN MANNED VESSELS.

e) SUPPLEMENTED BY SHIPBUILDING AND REPAIR FACILITIES.

THE JONES ACT (46 U.S.C. 883) IS SECTION 27 OF THE MERCHANT MARINE ACT OF 1920. AT THE TIME OF ITS ENACTMENT, IT REAFFIRMED NATIONAL POLICIES THAT WERE ALREADY OVER A CENTURY OLD. BASICALLY, IT REQUIRES THAT ALL SHIPMENTS OF MERCHANDISE BY WATER OR BY LAND AND WATER BETWEEN PORTS IN THE UNITED STATES, WHETHER DIRECT OR VIA A FOREIGN PORT, MUST BE MADE IN VESSELS WHICH ARE BUILT IN THIS COUNTRY, DOCUMENTED UNDER U.S. LAW, AND OWNED AND MANNED BY U.S. CITIZENS.

THROUGH ITS PROVISIONS, THE JONES ACT ENSURES THAT WE HAVE, IN BEING, A WATER TRANSPORTATION CAPABILITY THAT IS EXCLUSIVELY SUBJECT TO OUR OWN NATIONAL CONTROL RATHER THAN UNDER THE CONTROL OF FOREIGN SUPPLIERS, MANAGEMENT, OR LABOR. A CRITICAL ELEMENT OF THAT CAPABILITY IS THE FLEET OF PETROLEUM PRODUCT CARRIERS WHICH CAN BE DRAWN UPON FOR THE MOVEMENT OF MILITARY FUEL IN WARTIME. THE REQUIREMENT FOR DOMESTIC CONSTRUCTION OF THE VESSELS ALSO WORKS TO HELP SUSTAIN A SHIPBUILDING AND REPAIR ESTABLISHMENT WHICH REPRESENTS A CRITICAL NATIONAL MOBILIZATION RESOURCE.

DURING THE EARLY MONTHS OF THE KOREAN WAR, LEGISLATION WAS ENACTED WHICH PROVIDED FOR ADMINISTRATIVE WAIVERS OF THE NAVIGATION AND VESSEL INSPECTION LAWS, WHICH INCLUDED BUT ARE NOT LIMITED TO THE JONES ACT (ACT OF DECEMBER 27, 1950; P.L. 81-891; 64 STAT. 1120). WHEN IT IS DEEMED NECESSARY FOR THE NATIONAL DEFENSE OF THE UNITED STATES, THESE LAWS CAN BE WAIVED.

THE CUSTOMS SERVICE IN THE DEPARTMENT OF THE TREASURY IS RESPONSIBLE FOR PROCESSING JONES ACT WAIVER REQUESTS FOR PARTICULAR PROPOSED SHIPMENTS. THE CUSTOMS SERVICE SEEKS COMMENTS FROM MARAD AND OTHER INTERESTED AGENCIES. CUSTOMS CONSIDERS THESE COMMENTS AND PREPARES A RECOMMENDATION TO THE ASSISTANT SECRETARY OF THE TREASURY FOR ENFORCEMENT WHO MAKES THE APPROVAL OR DENIAL. BEFORE IT MAKES A RECOMMENDATION, MARAD DETERMINES IF SUITABLE U.S. VESSELS ARE AVAILABLE TO PERFORM THE SHIPMENT. IN CONSIDERING A WAIVER, MARAD MUST REVIEW WHETHER OR NOT THE NATIONAL DEFENSE INTEREST WOULD BE COMPROMISED. IF THE NATIONAL DEFENSE INTEREST IS NOT HARMED, MARAD WILL RECOMMEND DENIAL TO THE CUSTOMS SERVICE. PURELY COMMERCIAL DELIVERY TERMS, WHETHER OR NOT ECONOMICALLY VITAL TO A SHIPPER OR CONSIGNEE, CANNOT GOVERN THE AVAILABILITY DETERMINATION - THE LANGUAGE OF THE WAIVER STATUTE SIMPLY GIVES NO STANDING TO COMMERCIAL CONSIDERATIONS.

IT SHOULD BE NOTED, HOWEVER, THAT MARAD RECOMMENDATIONS ARE NOT BINDING ON THE U.S. CUSTOMS SERVICE OF THE DEPARTMENT OF THE TREASURY. OUR PRINCIPAL EXPERTISE AND COMMENTS IN ANY WAIVER

CASE RELATE TO THE AVAILABILITY OF U.S. FLAG VESSELS. THE WAIVER REVIEW PROCESS IS NOT DONE IN A VACUUM; THE VIEWS OF OTHER AGENCIES ARE ALSO GIVEN FULL WEIGHT. IT IS POSSIBLE THAT THE ARGUMENTS OF OTHER AGENCIES WILL PREVAIL AS TO THE REQUIRED TIMING OF A SHIPMENT AND ITS RELATION TO THE NATIONAL DEFENSE AND A RULING OPPOSED TO MARAD'S RECOMMENDATION WILL BE MADE.

BETWEEN DECEMBER 22, 1989 AND JANUARY 3 OF THIS YEAR, MARAD RECEIVED LETTERS FROM THE U.S. CUSTOMS SERVICE REQUESTING ADVICE ON REQUESTS FROM SIX DIFFERENT COMPANIES FOR WAIVERS TO PERMIT FOREIGN-FLAG VESSELS TO TRANSPORT FUEL OIL OR PROPANE BETWEEN U.S. DOMESTIC POINTS. MARAD RECOMMENDED DISAPPROVAL OF FOUR REQUESTS FOR FOREIGN-FLAG CARRIAGE OF HEATING OIL BECAUSE OF THE AVAILABILITY OF U.S.-FLAG VESSELS. HOWEVER, MARAD INTERPOSED NO OBJECTION TO THE WAIVERS FOR FOREIGN-FLAG PROPANE CARRIAGE AFTER A THOROUGH CHECK REVEALED NO U.S.-FLAG PROPANE CARRIERS WERE AVAILABLE. THE DETAILS REGARDING THE APPLICANTS AND MARAD'S ACTIONS ON THESE REQUESTS ARE AS FOLLOWS:

- AROCHEM CORPORATION OF STANFORD, CONNECTICUT. THIS COMPANY REQUESTED "AN IMMEDIATE GRANT OF AN EXEMPTION FROM THE AMERICAN FLAG VESSEL REQUIREMENT IMPOSED UNDER THE JONES ACT FOR THE DURATION OF THE WINTER OF 1990 FOR THE DELIVERIES OF [NO. 2 AND NO. 6 FUEL OIL FOR SHIPMENTS FROM THE U.S. GULF COAST TO THE EAST

COAST]." IN OTHER WORDS, AROCHEM REQUESTED A BLANKET WAIVER FOR THE SEASON. NO PARTICULAR VESSELS WERE THE SUBJECT OF THE REQUEST. AROCHEM DID STATE THAT IT HAD A JANUARY 15, 1990 DELIVERY COMMITMENT FOR 230,000 BARRELS OF NO. 6 FUEL OIL DESTINED FOR "A MAJOR NEW YORK AREA HEATING OIL DISTRIBUTION CONCERN."

MARAD REVIEWED THE AROCHEM REQUEST WITH A NUMBER OF U.S. TANKER OPERATORS, INCLUDING REPRESENTATIVES OF:

AMERICAN TRADING TRANSPORTATION COMPANY, INC.
COVE MARITIME COMPANIES, INC.
MORMAC MARINE TRANSPORT, INC.
OVERSEAS SHIPHOLDING GROUP/MARITIME OVERSEAS CORPORATION

AS A RESULT OF THESE CONTACTS, AROCHEM WAS OFFERED THE FOLLOWING U.S.-FLAG TANKERS:

- o MORMACSKY, AVAILABLE TO LOAD A CARGO IN PUERTO RICO ABOUT JANUARY 4.
- o DELAWARE TRADER, AVAILABLE ABOUT JANUARY 20
- o COVE TRADER, AVAILABLE ABOUT THE END OF JANUARY.
- o COVE LIBERTY, AVAILABLE ABOUT THE END OF JANUARY.
- o COVE LEADER, AVAILABLE ABOUT THE END OF JANUARY.
- o OVERSEAS CHICAGO, AVAILABLE ABOUT JANUARY 20.

BASED ON THIS SAMPLING, MARAD CONCLUDED THAT THERE WAS AMPLE TANKER TONNAGE GENERALLY AVAILABLE FOR THE CURRENT HEATING SEASON THAT COULD BE USED BY ANY QUALIFIED DISTRIBUTOR OR TRADER WHO WOULD ENTER INTO THE NECESSARY ARRANGEMENTS TO UTILIZE SUCH TONNAGE. ACCORDINGLY, MARAD RECOMMENDED DENIAL OF THE AROCHEM REQUEST.

-ENRON GAS LIQUIDS, INC., OF HOUSTON, TEXAS. THIS FIRM REQUESTED AN IMMEDIATE WAIVER FOR USE OF THE SPANISH VESSEL BUTADIEZ TO TRANSPORT PROPANE FROM THE GULF TO THE EAST COAST. WITH NO U.S. VESSELS AVAILABLE FOR THE TRANSPORT OF PROPANE, MARAD ADVISED CUSTOMS THAT WE WOULD NOT OBJECT TO THE WAIVER. ENRON WAS UNABLE TO HOLD THE VESSEL, HOWEVER, WHICH WAS ALREADY LOADED WITH THEIR CARGO FOR DELIVERY TO EUROPE. I SUGGEST THAT ENRON'S TIMING ON ITS ACTION WAS SIMPLY UNREALISTIC.

-BAY STATE GAS COMPANY OF CANTON, MASSACHUSETTS. THIS FIRM INITIALLY REQUESTED WAIVERS FOR TWO PROPANE CARRIERS, THE ITALIAN-FLAG LPG VESSEL ALESSANDRO VOLTA AND THE DANISH-FLAG LPG VESSEL SVEN MAERSK. BAY STATE COULD NOT HOLD A COMMITMENT ON THE ALESSANDRO VOLTA OVER THE WAIVER ACTION PERIOD, SWITCHED TO THE BUTADIEZ MENTIONED EARLIER, AND FINALLY REQUESTED A WAIVER ONLY FOR THE SVEN MAERSK. MARAD ADVISED CUSTOMS AS IT DID FOR THE ENRON REQUEST, THAT IT HAD NO OBJECTION TO GRANTING THE WAIVER.

-A.I.C. LIMITED, REPRESENTED BY LEWIS, RICE & FINGRSH OF ST. LOUIS. THIS FIRM CHARTERED THE BELGIAN-FLAG VESSEL PETROBULK LEOPARD TO CARRY FUEL OIL FROM TEXAS TO EUROPE. ACCORDING TO ITS APPLICATION, A.I.C. FOUND, EARLY INTO THE VOYAGE, THAT IT WOULD BE MORE ADVANTAGEOUS TO SELL THE FUEL OIL CARGO IN NORTH AMERICA. ACCORDINGLY, THE VESSEL WAS DIVERTED TO FREEPORT, BAHAMAS, WHERE THE OIL HAD BEEN PARTIALLY OFF-LOADED WHEN THE APPLICATION WAS MADE. A.I.C. WANTED TO RELOAD THE PETROBULK LEOPARD AND DELIVER THE CARGO TO THE U.S. EAST COAST. MARAD RECOMMENDED DENIAL OF THIS REQUEST ON THE BASIS OF A DEMONSTRATED GENERAL AVAILABILITY OF U.S.-FLAG TANKERS.

MARAD'S RECOMMENDATION TO ~~CUSTOM'S ON~~ THESE FIRST FOUR CASES WAS FAXED OUT ON DECEMBER 27. HAVING RECEIVED CUSTOM'S REQUEST ON DECEMBER 26TH, OUR ACTION, INCLUDING INITIAL DISCUSSION, RESEARCH, MAKING OF A DECISION, AND PREPARATION OF RESPONSE WAS COMPLETED IN LESS THAN TWO WORKING DAYS.

-COSCOL MARINE CORPORATION, REPRESENTED BY PAUL A. SCOFF OF HOUSTON TEXAS. ON DECEMBER 27, THIS FIRM ASKED FOR A WAIVER TO USE THE LIBERAN-FLAG TANKER PRODICOS TO CARRY FUEL OIL FROM NEW ORLEANS TO SOUTH BOSTON. THE PRODICOS WOULD HAVE BEEN USED IN PLACE OF THE U.S.-FLAG TANKER SPRAY, A 29,200 DWT VESSEL (OR ABOUT 198,000 BBL OF FUEL OIL). THE PRODICOS WOULD HAVE CARRIED AN ADDITIONAL 40,000 BBL ACCORDING TO THE APPLICANT'S LETTER TO CUSTOMS. MARAD RECOMMENDED DENIAL OF THIS WAIVER BASED ON ITS

EARLIER ASSESSMENT OF U.S.-FLAG AVAILABILITY. CUSTOMS SENT A COPY OF THE REQUEST TO MARAD ON DECEMBER 28, AND MARAD REPLIED ON DECEMBER 29.

-SHARPGAS, INC./CHESAPEAKE UTILITY, NEW ORLEANS. THIS FIRM ORIGINALLY REQUESTED A WAIVER TO USE THE ALESSANDRO VOLTA, PREVIOUSLY MENTIONED IN CONNECTION WITH THE BAY STATE GAS REQUEST, TO CARRY PROPANE FROM THE MOUNT BELLEVIEW TERMINAL IN HOUSTON TO MARCUS HOOK, PENNSYLVANIA. THIS REQUEST WAS MODIFIED TO SUBSTITUTE THE NORWEGIAN LPG VESSEL KONGSGAS FOR THE ALESSANDRO VOLTA AND, LATER, MODIFIED AGAIN TO REQUEST USE OF THE NORWEGIAN LPG NORGAS VOYAGER, WHICH HAS A CAPACITY OF 2.1 MILLION GALLONS OF PROPANE. MARAD'S RESPONSE ON THIS REQUEST WAS SIMILAR TO THOSE ON THE OTHER PROPANE REQUESTS; MARAD ADVISED THAT THERE WERE NO SUITABLE U.S.-VESSELS AVAILABLE FOR THE PROPOSED SHIPMENT. HENCE, MARAD HAD NO OBJECTION TO RECOMMENDING THE WAIVER. THIS RESPONSE WAS FAXED TO CUSTOMS ON JANUARY 5, AND TREASURY GRANTED THE WAIVER ON JANUARY 10. THE PROCEDURES FOLLOWED IN THESE CASES, AS THEY INVOLVED MARAD, REFLECTED EXTREMELY PROMPT AGENCY ACTION.

THE OBJECTIVES OF THE JONES ACT ARE AS VALID TODAY AS THEY WERE WHEN ENACTED. AT A TIME WHEN WE HAVE ALREADY EXPERIENCED A MAJOR DECLINE IN U.S.-FLAG TONNAGE AND IN U.S. SHIPBUILDING ACTIVITY, IT IS ALL THE MORE VITAL TO PRESERVE WHAT REMAINS OF

U.S. MARITIME CAPABILITY. THE EVENTS OF THE PAST FEW WEEKS ONLY UNDERSCORE THE IMPORTANCE AND THE GREAT POTENTIAL OF A MODERN U.S.-FLAG MERCHANT FLEET. MARAD BELIEVES THE JONES ACT CONTINUES TO BE CRITICALLY IMPORTANT TO THE NATIONAL DEFENSE AND COMMERCIAL NEEDS OF THIS COUNTRY.

THIS CONCLUDES MY PREPARED STATEMENT. I WOULD BE PLEASED TO RESPOND TO ANY QUESTIONS THE COMMITTEE MAY HAVE.

#

JAN 16 1990

VES-2-CO:R:P:C
110774 PH

STATEMENT

OF

PAUL HEGLAND

SENIOR ATTORNEY

OFFICE OF REGULATIONS AND RULINGS

U.S. CUSTOMS SERVICE

BEFORE THE

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

JANUARY 16, 1990

CUSTOMS ROLE IN THE JONES ACT AND WAIVERS

National Defense Waivers for Transportation of Fuel Oil and Propane to the Northeastern States

The Jones Act, 46 U.S.C. App. 883, prohibits the transportation of merchandise between points in the United States in any vessel other than a U.S. built, owned, and properly documented vessel. This prohibition applies to transportation between coastwise points via a foreign port and to any part of transportation between coastwise points. The penalties provided for violation of the Jones Act are forfeiture of the merchandise transported or an amount up to the value thereof.

Customs role with regard to the Jones Act is one of interpretation and enforcement. We interpret what is transportation included within the Jones Act and we penalize violators of the Jones Act. The Coast Guard is responsible for vessel documentation functions relating to the Jones Act (i.e., for determining what vessels may engage in Jones Act trade).

The only authority for waiver of the Jones Act and other coastwise laws is the Act of December 27, 1950 (64 Stat. 1120; note preceding 46 U.S.C. App. 1). Under this provision the Secretary of the Treasury is directed to grant a request for waiver of the coastwise laws, including the Jones Act, if the Secretary of the Defense requests that such a waiver be granted in the interest of national defense. If the Secretary of Defense does not make such a request, the Secretary of the Treasury has discretion to grant or deny a request for waiver of the coastwise laws "whenever he deems that such action is necessary in the interest of national defense."

Customs role with regard to these waivers depends on how the waiver is requested. If the Department of Defense requests the waiver, Customs has been delegated the authority to grant the waiver and does so without question. If Customs receives the waiver request from a private party or another government agency, and the Department of Defense does not request the waiver, Customs seeks the advice of other interested agencies about the waiver.

Customs always seeks the advice of the Department of Defense (regarding defense issues) and the Maritime Administration in the Department of Transportation (regarding the availability of qualified U.S. vessels to provide the transportation). We also seek the advice of other Federal agencies with an interest in the subject matter of the waiver (e.g., the Coast Guard in the Department of Transportation and the Department of Energy with regard to the EXXON VALDEZ oil spill cleanup, and the Department of Energy for the transportation of petroleum products). We recommend Treasury action on the waiver request based on this advice. The Department of the Treasury (Assistant Secretary for Enforcement) then grants or denies the waiver.

In the case of the waivers recently requested for the transportation of propane and heating oil to the Northeast, Customs has so far received six requests for waivers. Three of the waiver requests were for the transportation of propane and three pertained to various kinds of heating oil. Two of the requests for the transportation of propane were granted (the third became moot because the vessel for which the waiver was requested became unavailable before action could be taken). The first propane waiver was granted on December 28 and the second on January 10, each within 4 business days after it was requested. The requests for the transportation of heating oil were denied.

In the first three of these waiver requests, the Department of Defense found no direct impact on the interests of that Department and deferred to the interests of Federal agencies more directly involved. In the case of the other waiver requests, the Department of Defense supported granting the waivers if qualified U.S. vessels were determined not to be available within the needed time frame, although it still found no direct impact on its interests. The Department of Energy, citing the connection between energy availability and National defense, strongly urged the granting of the waivers if qualified U.S. vessels were not timely available. The Maritime Administration opposed the granting of waivers for the transportation of fuel oil because it stated that it had found qualified U.S. vessels available to provide the transportation for which the waivers were requested.

The Maritime Administration stated that it would not object to the granting of the waivers for the transportation of propane because it had been unable to identify qualified U.S. vessels to transport the propane.

I will be happy to answer any questions at this time, Mr. Chairman.

TESTIMONY SUBMITTED BY

CHARLES J. DIBONA, PRESIDENT
AMERICAN PETROLEUM INSTITUTE

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

JANUARY 16, 1990

Good morning. My name is Charles J. DiBona. I am President of the American Petroleum Institute, a trade association representing over two hundred companies engaged in all facets of the petroleum business. I am grateful to have been invited to provide the industry's view of recent events in heating oil markets.

Before doing so, however, I would like to offer two caveats. Because of constraints of anti-trust laws, the American Petroleum Institute is not privy to specific pricing decisions of its member companies and it cannot speculate about future prices. Nevertheless, I believe I can shed light on important aspects of what has been happening as we do collect overall industry supply, inventory and production statistics.

In my testimony today, I will discuss three main points. First, I will cover the extraordinary efforts that the U.S. petroleum industry has made to provide more heating oil to the Northeast and other areas that suffered through the record cold of December. Because of those efforts, the nation's 11 million homes which use this fuel were kept supplied even during the worst of the cold weather. Second, I will describe how the higher prices that consumers paid for heating oil enabled refiners, wholesalers, truckers, barge operators, retailers -- literally thousands of companies -- to undertake accelerated and more costly methods of supply at the same time that much of their normal equipment was damaged by the harsh weather. And third, I will discuss some steps the government might take to help address the kind of problems that heating oil customers faced in December.

During December retail prices for heating oil increased on the order of 40 cents a gallon in some areas of the Northeast. Those higher prices are due to an unprecedented rapid increase in heating oil demand -- estimated to be about 500,000 barrels a day nationwide -- brought about primarily by cold weather that the National Oceanic and Atmospheric Administration (NOAA) has termed a "record rare event," with temperatures in the Northeast the coldest in over 70 years. Demand for heating oil at severely impacted terminals in the Northeast appears to have increased by at least 50 percent during the early part of December. This extraordinary increase occurred from an increase of some 35 percent in the use of oil for heating purposes, from switching to fuel oil by interruptible natural gas customers whose gas supplies were curtailed, and from increased use of fuel oil for electricity generation made necessary by the weather's impact on hydroelectric generation in Canada and by the increased use of oil-fired generating facilities.

Such a sudden and substantial demand increase cannot be fully anticipated or prevented. However, the higher prices that resulted have enabled the thousands of different companies that are part of the production-transportation-distribution system to take more costly steps for increasing the supply. Those additional steps assured that, so far as we are aware, no individual or institution failed to have heating oil when it was needed.

During the heating season, current domestic refinery production usually provides almost 90 percent of U.S. heating oil supplies, and in the first three weeks of December domestic refiners stepped up their production of heating oil to record levels. Refinery production of heating oil for December is estimated to be the highest for that month in eleven years. Refineries achieved these production levels despite problems they faced when cold weather struck the Gulf Coast in the latter part of December, disrupting operations in this nation's primary refining region. Temperatures along the Gulf Coast were 40 to 50 percent colder than normal in the last week in December. That colder weather reduced refinery production of fuel oil by about 500,000 barrels a day, primarily because of such weather-related problems as burst pipes, frozen pumps, stuck gauges and frozen cooling towers. The cold weather also caused some natural gas production facilities to freeze up, thus reducing the energy source that some refineries use for their operation.

Despite these problems, refiners provided the amounts needed by consumers because the higher prices in the market enabled them to undertake a vast array of higher-cost operations. They would not have been able to undertake all of these steps had heating oil prices not risen. Instead, those higher prices prompted refiners to:

o Buy more expensive crude supplies on the spot market.

o Run more crude oil through refineries even though this increased the amounts of other, less needed products.

o Alter crude oil runs to produce more heating oil and less gasoline from each barrel of crude. Gasoline production in the first three weeks of December was about 200,000 barrels a day less than December 1988 despite increased crude runs, primarily because of refiners' attempts to produce more heating oil.

o Operate refineries more intensively, at their physical limits, and ultimately endure greater maintenance and repair costs as a result.

o Alter pipeline shipments to transport more heating oil and less of other products such as gasoline.

Companies also intensified their efforts to import more fuel oil to help meet the demand in December. Imports usually account for about 6 percent of total winter supplies. Colder temperatures also affected Europe late in 1989 and raised heating oil demand and prices there. As a result, more world fuel oil supplies went to Europe and fewer barrels could be imported to this country. For all of December, imports of fuel oil averaged about 360,000 barrels a day compared to over 400,000 barrels a day a year earlier. However, during the last three weeks of December and the first week of January, imports averaged about 420,000 barrels a day, up 100,000 barrels a day from November, largely because higher prices in the United States enabled importers to increase their purchases.

Furthermore, recent heating oil imports have been on a rising trend and initial reports indicate that since mid-December significant additional amounts of fuel oil have been purchased in Europe for Northeast delivery. These supplies will arrive throughout January. There is of course no assurance that they can be sold at prices high enough to recover their cost as spot prices recently have been falling sharply.

These rising imports not only have directly helped to supply the increased demand but have been an important factor allowing companies to make rapid withdrawals from their inventories. Going into December, inventories were at about the levels they have been for the past few winters -- winters that turned out to be quite mild, incidentally. With these levels and knowing that imported supplies were on the way to replenish inventories in January, refiners, bulk terminals and pipelines were able to draw heavily upon their inventories in December. In fact, inventories were drawn down at a rate that approached 500,000 barrels or 20 million gallons a day for a large part of the month. That is an unusually high rate for the month of December by recent historical standards. During three of the last five years fuel oil inventories actually grew in December. This past December, however, withdrawals from inventories accounted for about 11 percent of supply. But, even with the withdrawals this past December, stocks remain adequate to continue supplying fuel oil at the same rate as December for more than seven weeks, if necessary.

Transporters, wholesalers and retailers also stepped up their efforts to move heating oil toward final customers. In the Northeast, heating oil demand at the most impacted terminals increased by 50 percent or more, requiring daily deliveries to be greatly increased despite slippery roads, icy rivers, frozen equipment and other weather-related problems that made these operations more difficult and more costly. People in the system worked overtime including Christmas Eve and New Years. Because pipeline capacity was filled, companies relied more heavily on barges and trucks to transport fuel oil long distances. Kerosine jet fuel was mixed with heating oil to keep it fluid in the frigid weather, reducing stocks of that fuel. These various mechanisms to enhance transportation are costly and would not be efficient to use in normal circumstances.

While the experiences of each company are different, it is clear that each faced extraordinary circumstances. For example, one major U.S. oil company has recently informed us that it increased its sales of heating oil in the Northeast states this past December by nearly 80 percent compared to its sales for the same month a year ago. This company's sales in Connecticut were up more than 350 percent over December 1988 and they were up nearly 450 percent in Massachusetts. To do this, the company changed its refinery product mix, purchased heating oil on the spot market (often at prices above its own selling price), leased additional barges and ran its operations 24 hours a day throughout the holiday season.

Because of efforts such as those, deliveries were made to those needing additional heating oil in virtually every case. Considering the weather conditions that existed during December and that there are 11 million home heating oil customers nationwide, this is a tremendous physical achievement.

I am aware that the rise in price during this period is of concern to the public and to its elected representatives. Yet, as prices rose, companies across the nation were able to undertake the extraordinary measures to supply the market that they in fact took. That is because the measures adopted to ensure extraordinary levels of supply also incurred extraordinary costs.

Further, these actions along with a moderation in weather conditions in the East and South, have put downward pressure on heating oil prices. For example, wholesale prices in New York of No. 2 oil -- which includes heating oil -- dropped by 26 cents a gallon to 87 cents a gallon in just one week. Also, futures prices for February delivery on the New York Mercantile Exchange have dropped by about 10 cents a gallon. Historically, sustained changes in prices on the futures and spot markets have been followed by similar changes in the wholesale and retail levels. Also, even with the recent price rise, retail prices this past December were less, after adjustment for inflation, than they were nearly a decade ago.

Undoubtedly, despite the industry's increased costs to meet the demand, profits rose -- just as they fall during periods of glut. But it is clear from the evidence that the companies did much more than simply take in profits; they reacted to the situation with greatly increased activity. It is also clear that because of the greater operational costs involved and the costs imposed by the physical damage to facilities from the cold weather, the increase in profits is less than many perceive.

I do not have information about the profitability of petroleum companies in the last quarter of 1989. But I can document that for each year between 1984 and 1988 and also for the first three quarters of 1989, the 20 leading U.S. oil companies made a lower rate of return on their investment than did non-petroleum manufacturing companies generally. Over an even longer period, 1968 - 1988, petroleum companies had a lower average annual rate of return on investment than did non-petroleum manufacturing generally. The simple fact is that the oil industry is highly competitive and cannot set prices to assure high profits. Prices -- and profit levels -- instead are set by market forces of supply and demand.

I am certain that members of this committee are interested in what can be done to minimize problems in the future. First of all, although the type of phenomena we have been experiencing are relatively infrequent, price spikes pose special hardships when they do occur for people who rely on heating oil and who are on low or fixed incomes. API believes that the government can address this problem best by providing direct financial help to those who are most in need. For this reason, API long has supported the government's Low Income Energy Assistance program, and we continue to believe this is a worthwhile and necessary mechanism to deal with this problem.

Second, the government should examine whether there might be ways during short-term emergency periods such as that experienced in December to ease any administrative barriers that might face shippers. For example, according to news reports, some companies with access to foreign tankers could not obtain waivers under the Jones Act to enter these ships in East Coast ports during December, even though petroleum pipelines had no free capacity and U.S. vessels were not readily available to carry cargoes to that region from the Gulf Coast. We have no first-hand evidence on this issue but availability of transportation capacity is crucial during times of extraordinary demand. If there were delays, the government should review its procedures to eliminate any unneeded hurdles.

Some have proposed that governments build stocks of heating oil as a way to reduce the risk of price spikes during unusually cold weather. We have argued that the federal Strategic Petroleum Reserve is best constructed and maintained as crude oil in salt caverns because that is the least costly way to hold such a reserve. We have taken no position on state or local stockpiles, but would offer the following observations.

First, publicly held stocks could help to alleviate sharp price shocks under unusual weather or operating conditions, but they would also mean significant costs for taxpayers during the majority of winters when no unusual events occur. The conditions of December 1989, for example, last occurred in the East in 1917. If public stocks are held for a 1 in 70 event, then 69 times out of 70 the public will foot the bill with no return.

Second, it is possible that government-held regional stocks of heating oil would tend to reduce incentives to hold private stocks. Thus, the program could be in part self-defeating.

Third, product stockpiles, unlike crude oil, have to be actively managed to keep the product fresh and thus usable. This means ongoing operating costs for such stockpiles.

Finally, larger product inventories address only a part of the overall problem that occurs when demand suddenly skyrockets. Transportation and delivery facilities also become short during extremely harsh weather, no matter how large stocks are or whether they are controlled by private industry or by governments. The petroleum industry called upon stocks this past December to meet about twice the portion of demand that stocks normally meet during the heating season. But, getting that oil from where inventories were located and into customer tanks in the Northeast and Midwest was still a difficult physical problem. Government-owned product stocks thus could only be a part of any emergency measure, and perhaps not even the most crucial part.

Conclusion

The petroleum industry has been making extraordinary efforts to provide more heating oil to the Northeast and other areas of the country that have suffered during the record cold weather of late fall and early winter.

U.S. refiners have dramatically increased production of heating oil. Oil companies have made extraordinary withdrawals from inventories and maintained import levels in the face of greater international competition. Despite formidable operational problems caused by the extreme cold, greater amounts of heating oil have been delivered to customers. The higher prices paid by consumers enabled the industry to undertake a wide variety of more intensive, more costly steps to produce more heating oil, to import more heating oil, to increase withdrawals and to accelerate deliveries to consumers.

The industry's greater supply efforts, coupled with the effects of moderating temperatures on demand, have shown signs of relieving upward price pressure as of early January.

American Petroleum Institute
1220 L Street, Northwest
Washington, D.C. 20005
202-682-8100

Charles J. DiBona
President

January 31, 1990

The Honorable
Joseph I. Lieberman
502 Senate Hart Office Building
United States Senate
Washington, D.C. 20510

Dear Senator Lieberman:

During the hearing on January 16, 1990 regarding heating oil supply and prices, I was asked a question about the percentage of the market that is controlled by the ten largest companies. I indicated I would provide that information for the record.

I am enclosing the latest data that API has in respect to crude oil production, refining capacity, refinery runs, and motor gasoline sales. In addition, I am enclosing a copy of the most recent edition of the API report on market shares from which these data are taken. We anticipate that this report will be updated in 1990 to include data available through 1989.

If you have any further questions, please feel free to contact me. Again, I appreciated the opportunity to appear before your committee on this important issue.

Sincerely,

Charles J. DiBona

Enclosure(s)

ANSWERS TO BE SUPPLIED FOR THE RECORD

Question 1

Provide what percentage of the market is controlled by the 10 largest companies. List the 10 companies and the percentage of the market they control.

Answer

Attached are the latest data compiled by API from public sources on the market shares of the largest companies in respect to crude oil production, refining capacity, refinery runs (the total input processed through crude oil distillation units) and motor gasoline.

The largest ten-firm market shares for these measures are as follows:

Crude oil production, 50.7 percent;
Refining capacity, 58.7 percent;
Refinery runs, 60.8 percent; and,
Motor gasoline sales, 54.6 percent

It should be noted that these markets are relatively "unconcentrated" according to tests that are applied by the Justice Department and Federal Trade Commission. Concentration levels in the petroleum industry are less than in many other major U.S. industries.

API does not have information on the market shares of distillate products (diesel fuel, heating oil) accounted for by the largest refiners, nor on the shares of distribution terminals, wholesalers, and dealers of fuel oil. U.S. Census Bureau data on establishments indicate that many such firms exist. For example, Connecticut is served by approximately 70 bulk stations and terminals, about 50 additional wholesalers, and approximately 430 fuel oil dealers. Questions concerning these data could be directed to the Census Bureau.

For your information, I am attaching a copy of the most recent edition of the API report on market shares. This report will be updated during 1990 to include data through 1989.

1/29/90
lgb/tfh

TABLE 17

U.S. CRUDE OIL, CONDENSATE AND NATURAL GAS LIQUIDS PRODUCTION, 1987
(000 Bbl/day)

Company	Production	Percent of U.S. Total
BP America (Standard Oil)[1]	851.3	8.51
Exxon	756.0	7.55
ARCO	665.0	6.64
Shell	558.0	5.58
Texaco	540.0	5.40
Chevron	506.9	5.06
Amoco	394.0	3.94
Mobil	338.0	3.38
Phillips	287.0	2.87
USX	171.1	1.71
Unocal	167.0	1.67
Sun	159.3	1.59
Occidental	129.0	1.29
DuPont	107.0	1.07
Tenneco	100.9	1.01
Burlington Northern	79.8	0.80
Amerada Hess	68.5	0.68
City of Long Beach[2]	67.8	0.68
Union Pacific	61.1	0.61
Enron	57.1	0.57
Santa Fe	52.3	0.52
Valero Energy	46.4	0.46
Mitchell[3]	39.1	0.39
CSX Corporation	33.7	0.34
Louisiana Land & Exploration	31.2	0.31
Pennzoil	31.0	0.31
Enserch	27.7	0.28
Kerr-McGee	26.6	0.27
Freeport-McMoRan	21.9	0.22
Mesa	17.9	0.18
U.S. Total[4]	10,008.0	100.0
Top 4	2,830.3	28.3[5]
8	4,609.2	46.1
15	5,730.5	57.3
20	6,064.8	60.6
30	6,392.6	63.9
Herfindahl-Hirschman Index	**310.3**	

Notes

[1] BP America was formed in 1987 through the acquisition of The Standard Oil Company by BP North America Inc.

[2] Long Beach, California owns several oil fields and a large percentage of the oil produced from these fields. It has contracts with ARCO, Exxon, Mobil, Shell, Texaco, Unocal and others to develop the properties. Because the oil owned by Long Beach is not included in the contracted companies' net production figures, the city has been included as a separate incorporated municipality.

[3] Mitchell's figure is for the year ending January 31, 1988.

[4] Includes crude oil, condensate, natural gas plant liquids, other hydrocarbons, and alcohol.

[5] Individual percentages may not add to totals due to rounding.

Sources: Company annual reports and form 10-Ks; correspondence with companies; and U.S. Department of Energy, Monthly Energy Review, March 1988, p. 38 (U.S. total).

TABLE 45

U.S. REFINING CAPACITY, 1987[1]
(000 Bbls/day)

Company	Capacity	% of Total Capacity
Chevron	1,718.6	11.35
Exxon	1,169.0	7.72
Shell	1,065.7	7.04
Amoco	939.0	6.20
Texaco	881.5	5.82
Mobil	755.0	4.99
ARCO	668.0	4.41
BP America (Standard Oil)[2]	667.6	4.41
USX	513.0	3.39
Unocal	497.0	3.28
Sun[3]	460.0	3.04
Du Pont	394.3	2.60
Ashland	346.5	2.29
Phillips	305.0	2.01
Coastal	290.4	1.92
Koch	280.0	1.85
Petroleos de Venezuela[4]	226.1	1.49
Total Petroleum	191.1	1.26
Kerr-McGee	164.8	1.09
Solomon	155.7	1.03
MAPCO	150.0	0.99
Southland	148.5[5]	0.98
Diamond Shamrock Refining & Marketing[6]	145.0	0.96
American Petrofina	145.0	0.96
Tenneco	145.0	0.96
Union Pacific	142.6[7]	0.94
APEX	128.2	0.85
Tosco	126.0	0.83
Sinclair	125.5	0.83
Atlantic Refining & Marketing	125.0	0.83
U.S. & Puerto Rico Total	15,139.0	100.0
Top 4	4,892.3	32.3[8]
8	7,864.4	52.0
15	10,670.6	70.5
20	11,688.3	77.2
30	13,069.1	86.3
Herfindahl-Hirschman Index		**448.2**

Notes

[1] Operating capacities of refineries in the U.S. and Puerto Rico as of January 1, 1988. Excludes Guam and Virgin Island operations.

[2] BP America was formed in 1987 through the acquisition of The Standard Oil Company by BP North America Inc.

[3] Sun's figure includes 85,000 b/d from a refinery in Yabucoa, Puerto Rico.

[4] Petroleos de Venezuela, the Venezuelan national oil company, owns one-half of Citgo Petroleum and one-half of Champlin Refining Company. In 1987, Citgo's operable refining capacity averaged 297,000 b/d, and Champlin's averaged 155,200 b/d.

[5] This figure represent's Southland's 50 percent interest in Citgo Petroleum. In 1987, Citgo's operable refining capacity averaged 297,000 b/d.

[6] Diamond Shamrock Refining & Marketing became an independent company on April 30, 1987 when it was spun-off from Maxus Energy Corporation (the former Diamond Shamrock Corporation).

[7] This figure represents Union Pacific's 50 percent interest in Champlin Refining Company and 100 percent interest in Union Pacific's Resources. In 1987, Champlin's operable refining capacity averaged 155,200 b/d, and Union Pacific Resources' averaged 65,000 b/d.

[8] Individual percentages may not add to totals due to rounding.

Source: U.S. Department of Energy, *Petroleum Supply Annual, 1987*, Volume 1, May 1988, pp. 72-101.

TABLE 54

U.S. REFINERY RUNS, 1987[1]
(000 Bbls/day)

Company	Runs[2]	Percent of U.S. Total
Chevron	1,387.7	10.71
Exxon	1,026.0	7.92
Shell	969.0	7.48
Amoco	842.0	6.50
Texaco	836.0	6.45
ARCO[3]	669.4	5.17
Mobil	645.0	4.98
BP America (Standard Oil)[4]	622.5	4.81
USX	452.5	3.49
Unocal	428.0	3.30
Sun	427.2	3.30
DuPont	348.0	2.69
Ashland[5]	319.1	2.46
Phillips[6]	302.0	2.33
Petroleos de Venezuela[7]	194.3	1.50
Coastal[8]	173.8	1.34
Total Petroleum (NA) Ltd.	172.7	1.33
American Petrofina	156.6	1.21
Diamond Shamrock Refining & Marketing[9]	141.5	1.09
Kerr-McGee	140.9	1.09
U.S. & Puerto Rico Total	12,952.2	100.0
Top 4	4,224.7	32.6[10]
8	6,997.6	54.0
15	9,468.7	73.1
20	10,254.2	79.2
Herfindahl-Hirschman Index		**463.3**

Notes

[1] Excludes Virgin Island and Guam operations.

[2] Figures should be considered approximations because of varying reporting practices among firms. Furthermore, since some firms include both crude oil run in their refineries for others and crude run for the company's account by others, the market shares could be overstated.

[3] ARCO's runs include 291,800 b/d from its Lyondell Petrochemical Company.

[4] BP America was formed in 1987 through the acquisition of The Standard Oil Company by BP North America Inc.

[5] Ashland's figure is for the year ending September 30, 1987.

[6] Phillips runs exclude 195,000 b/d of natural gas liquids processed.

[7] Petroleos de Venezuela, the Venezuelan national oil company, owns one-half of Citgo Petroleum and one-half of Champlin Refining company. In 1987, Citgo's refinery runs averaged 241,000 b/d, and Champlin's averaged 147,560 b/d (The Southland Corporation owns the other half of Citgo Petroleum, and The Union Pacific Corporation is the joint partner in Champlin Refining.)

[8] Coastal's runs exclude 47,000 b/d processed for others.

[9] Diamond Shamrock Refining & Marketing became an independent company on April 30, 1987 when it was spun-off from Maxus Energy Corporation (the former Diamond Shamrock).

[10] Individual percentages may not add to totals due to rounding.

Sources: Company annual reports and form 10-Ks; correspondence with companies; and U.S. Department of Energy, Monthly Energy Review, March 1988, p. 43. (The total amount of runs includes 98,200 b/d from Puerto Rico.)

TABLE 71

U.S. MOTOR GASOLINE SALES, 1987[1]
(000,000 gallons)

Company	Sales	Percent of Nat'l Market
Shell	9,074.7	8.10
Amoco	8,179.9	7.31
Exxon	7,608.7	6.80
Mobil	7,527.9	6.72
Chevron	7,233.2	6.46
Texaco	7,084.6	6.33
Unocal	4,118.9	3.68
BP America (Standard Oil)[2]	3,717.2	3.32
Phillips	3,420.4	3.05
ARCO	3,201.5	2.86
Sun	2,917.7	2.61
USX[3]	2,720.2	2.43
DuPont[4]	2,373.5	2.12
Ashland	1,898.5	1.70
Petroleos de Venezuela[5]	1,655.3	1.48
Cumberland Farms	1,469.6	1.31
Southland[6]	1,458.5	1.30
Coastal[7]	1,005.0	0.90
Diamond Shamrock Refining & Marketing[8]	952.9	0.85
Tenneco	929.4	0.83
American Petrofina	919.5	0.82
Getty Petroleum	803.8	0.72
Amerada Hess	780.0	0.70
APEX[9]	699.4	0.62
Kerr-McGee[10]	692.0	0.62
Total Petroleum	677.5	0.61
Atlantic Refining & Marketing	667.7	0.60
Tosco	646.1	0.58
Murphy	604.5	0.54
Union Pacific[11]	541.2	0.48
U.S. Total	111,965.4	100.0
Top 4	32,391.2	28.9[12]
8	54,545.1	48.7
15	72,732.2	65.0
20	78,547.6	70.2
30	85,579.3	76.4
Herfindahl-Hirschman Index	**367.3**	

Notes

[1] The data represent net taxable sales of motor gasoline in the U.S. All net taxable sales, both branded and unbranded, are included. Lundberg Survey, Inc. obtains data primarily from state tax collecting agencies, and also by direct inquiry.

[2] BP America was formed in 1987 through the acquisition of The Standard Oil Company by BP North America Inc.

[3] USX's figure includes sales under the brand name Marathon, and affiliated brands.

[4] DuPont's figure includes sales under the brand name Conoco, and affiliated brands.

[5] Petroleos de Venezuela, the Venezuelan national oil company, owns one-half of Citgo Petroleum, and one-half of Champlin Refining Company.

[6] Southland's figure represents the Southland Corporation's 50 percent ownership of Citgo Petroleum.

[7] Coastal's figure includes sales under the brand names Belcher, Derby, Pester, Joy, and affiliated brands.

[8] Diamond Shamrock Refining & Marketing became an independent company on April 30, 1987 when it was spun-off from Maxus Energy Corporation (the former Diamond Shamrock).

[9] APEX's figure includes sales under the brand name Clark and affiliated brands.

[10] Kerr-McGee's figure includes sales under the brand names Triangle and Deep Rock, and affiliated brands.

[11] Union Pacific's figure includes sales from Union Pacific's wholly-owned subsidiary, Union Pacific Resources, and from Union Pacific's 50 percent ownership of the Champlin Refining Company.

[12] Individual percentages may not add to totals due to rounding.

Source: Lundberg Survey, Inc., National Share of the Market, August 3, 1988.

TESTIMONY

BY

GLENN F. TILTON

PRESIDENT

OF

TEXACO REFINING AND MARKETING INC.

BEFORE

THE

U.S. SENATE GOVERNMENT AFFAIRS COMMITTEE
WASHINGTON, D.C.

JANUARY 16, 1990

THANK YOU. MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE.

MY NAME IS GLENN TILTON AND I AM PRESIDENT OF TEXACO REFINING AND MARKETING INC.

THE CIRCUMSTANCES WHICH BRING US TOGETHER THIS MORNING ARE OBVIOUSLY VERY IMPORTANT AND WE AT TEXACO HOPE THAT OUR PARTICIPATION WILL HELP TO CLARIFY WHAT HAS BECOME A MATTER OF GREAT CONCERN AMONG COMMUNITY LEADERS, GOVERNMENTAL OFFICIALS AT ALL LEVELS, AND PERHAPS MOST IMPORTANTLY, AMONG CONSUMERS OF OUR PRODUCTS. THAT ISSUE, OF COURSE, IS THE BACKGROUND BEHIND THE RECENT SUPPLY, DEMAND AND PRICE MOVEMENTS OF HOME HEATING OIL DURING THE BITTERLY COLD MONTH OF DECEMBER.

TEXACO'S AFFILIATE, STAR ENTERPRISE, HAS APPROXIMATELY A 7.5 PERCENT SHARE OF THE HEATING OIL MARKET IN THE NORTHEAST. THIS WOULD PLACE US AS THE FOURTH LARGEST SUPPLIER IN THE REGION. WE REFINE CRUDE OIL INTO HEATING OIL AND OTHER PRODUCTS AND MARKET THEM. IN MANY PLACES, WE SELL IN BULK TO LARGE INDEPENDENT TERMINAL OPERATORS WHO IN TURN SELL TO INDEPENDENT HEATING OIL DISTRIBUTORS WHO THEN SELL TO RESIDENTIAL CONSUMERS. WE ALSO PURCHASE HEATING OIL FOR RESALE FROM OTHER REFINERS OR FROM IMPORTERS OR FROM TRADERS. APPROXIMATELY 7% OF THE HEATING OIL WE SELL IN THE NORTHEAST IS SOLD DIRECTLY TO THE CONSUMER THROUGH FOUR RETAIL COMPANIES THAT WE OWN. IN A CHANGING MARKET - WHETHER PRICES ARE RISING OR FALLING - WE MAY MAKE THOUSANDS OF COMPLEX PURCHASE AND SALE TRANSACTIONS TO BALANCE OUR SYSTEM.

THE PERVASIVE QUESTION BEING ASKED BY THE PUBLIC AT THIS TIME IS QUITE SIMPLY - WHY DID THE PRICE OF HEATING OIL GO UP?

WHILE THIS IS BOTH AN OBVIOUS AND UNDERSTANDABLE QUESTION, I THINK IT IS EQUALLY IMPORTANT TO ASK TWO PERHAPS LESS OBVIOUS QUESTIONS - WHY WAS DEMAND FOR HEATING OIL SO HIGH AND WHAT FACTORS IMPACTED THE INDUSTRY'S AND OUR COMPANY'S ABILITY TO SUPPLY THAT DEMAND?

THE MORE IMPORTANT CONDITIONS WHICH IMPACTED THE SUPPLY, DEMAND AND PRICE OF HEATING OIL THIS WINTER ARE AS FOLLOWS:

- THE WEATHER IN THE NORTHEASTERN UNITED STATES DURING DECEMBER 1989 AVERAGED 30 PERCENT COLDER THAN NORMAL. THIS ARCTIC COLD FRONT CAUSED MORNING LOW AND AVERAGE DAILY TEMPERATURES ACROSS THE NATION TO PLUMMET.

- This icy cold, coupled with freezing rain and snow penetrated as far south as Texas and Florida causing operating problems in many Gulf Coast refineries which are a prime source of home heating oil for the Northeast. As an example, the morning low temperature at my home in Houston was 7 degrees F. The average low temperature for December 23 in Houston is 42 degrees F, some 35 degrees warmer than our December 23, 1989 low.

- The December 24 explosion at Exxon's Baton Rouge, Louisiana Refinery resulted in a loss of 2.5 Million barrels in production over a ten day period. When coupled with increased demand in Europe, additional strains were placed on the U.S. heating oil supply situation.

- The severe cold weather caused disruptions in refinery operations in many locations and to the transportation system upon which we rely for the delivery of heating oil.

- THE API HAS ESTIMATED THAT AS MUCH AS 800,000 BARRELS PER DAY OR ABOUT 11 PERCENT OF THE U.S. REFINING CAPACITY WAS LOST DURING THE LAST WEEK OF DECEMBER DUE TO THESE FACTORS.

- FINALLY, THERE IS NO EXCESS CAPACITY IN THE U.S. REFINING SYSTEM TO COVER LARGE SURGES IN DEMAND. EVEN WITH RECORD HEATING OIL PRODUCTION OF 3.4 MILLION BARRELS PER DAY FOR THE WEEK ENDING DECEMBER 15, 1989, A LARGE INCREASE IN IMPORTS WAS REQUIRED TO MEET DEMAND.

DEMAND FOR HEATING FUELS INCREASED BY SOME 25 TO 30 PERCENT NATIONALLY DURING THE PERIOD, WITH DEMAND INCREASES IN THE NORTHEAST ESTIMATED TO BE AS HIGH AS 50 TO 75 PERCENT. THESE CONDITIONS INTENSIFIED THE TIGHT SUPPLY SITUATION IN AREAS OTHER THAN NEW ENGLAND AND REQUIRED PURCHASES OUTSIDE OF NORMAL SUPPLY CHANNELS INCLUDING FOREIGN MARKETS WHICH WERE ALREADY EXPERIENCING A TIGHTENING OF SUPPLY AND INCREASED DEMAND IN THEIR MARKET. IN EUROPE A SUPPLY DISRUPTION CAUSED BY LOW WATER LEVELS IN THE RHINE RIVER RAISED EUROPEAN PRICES, MAKING THE COST OF ATTRACTING INCREMENTAL HEATING OIL SUPPLIES TO THE U.S. MUCH MORE EXPENSIVE.

FUNDAMENTAL LAWS OF SUPPLY AND DEMAND DICTATE THAT AS SUPPLIES OF A SCARCE RESOURCE DECLINE, AND DEMAND FOR THAT SAME RESOURCE INCREASES, THE PRICE WILL INVARIABLY RISE TO A LEVEL SUFFICIENT TO EQUALIZE THE SUPPLY AND DEMAND EQUATION AS IT DID IN THE PRESENT SITUATION.

ALL OF THESE ELEMENTS CONTRIBUTED TO AN INCREASE IN THE PRICE OF HEATING OIL. FOR EXAMPLE, THE PRICE OF #2 HEATING OIL ON THE NEW YORK MERCANTILE EXCHANGE INCREASED 70 PERCENT FROM NOVEMBER 27 TO DECEMBER 29, 1989, FOR SHIPMENT TO NEW YORK HARBOR.

AS WE PREPARED FOR THE 1989-1990 HOME HEATING SEASON, MINDFUL THAT OUR NORMAL DEMAND WAS 187 MILLION GALLONS OF HEATING OIL DURING AN AVERAGE WINTER, WE BELIEVE OUR INVENTORY POSITION GOING INTO THIS WINTER SEASON WAS ADEQUATE TO MEET PROJECTED NEEDS. LARGER INVENTORIES THAN REQUIRED CREATE SIGNIFICANT ADDITIONAL COSTS FOR CONSUMERS.

IN STARK CONTRAST TO PROJECTED DEMAND FOR HOME HEATING FUEL FOR DECEMBER 1989, WE DELIVERED AND SOLD 91 MILLION GALLONS, AN INCREASE OF 54 PERCENT OVER THE SAME PERIOD OF 1988. SOME 41 MILLION GALLONS OF THAT PRODUCT HAD TO BE PURCHASED BY OUR COMPANY ON THE OPEN MARKET WHERE SUDDEN AND DRASTIC PRICE INCREASES WERE TAKING PLACE AS A RESULT OF HEATING OIL SUPPLIERS BOTH IN THE U.S. AND INTERNATIONALLY COMPETING FOR THE SAME BARRELS OF PRODUCT. IF WE HAD NOT BEEN WILLING TO PAY INCREASED PRICE LEVELS, WE WOULD NOT HAVE BEEN ABLE TO KEEP OUR CUSTOMERS IN THE NORTHEAST FULLY SUPPLIED.

WE KNOW THAT THE FIRST CONCERN OF OUR CUSTOMERS IS AVAILABILITY OF HEATING OIL SUPPLIES. HIGHER PRICES ARE NEVER POPULAR, BUT THEY ARE FAR PREFERABLE TO THE PERSONAL AND ECONOMIC HARDSHIPS THAT WOULD OCCUR WITH A FAILURE TO SUPPLY. WE WERE ABLE TO SUPPLY ALL OF OUR REGULAR CUSTOMERS WITH HEATING OIL DURING THIS COLD SPELL IN THE NORTHEAST. IN FACT, OUR DEDICATED TRUCK DRIVERS, TERMINAL OPERATING PERSONNEL, DISPATCHERS AND OTHER SUPPORT PEOPLE REGULARLY WORKED DOUBLE SHIFTS INCLUDING WEEKENDS AND HOLIDAYS TO ENSURE THAT PRODUCT WAS DELIVERED TO WHERE IT WAS MOST NEEDED. UNFORTUNATELY, OUR DELIVERY DRIVERS REGULARLY REPORTED STOPS AT HOMES WHERE AS LITTLE AS 25 GALLONS OF HEATING OIL WAS NEEDED TO FILL A 250 OR 300 GALLON TANK, WHICH DELAYED DELIVERIES TO CUSTOMERS TRULY IN NEED OF PRODUCT.

YES, HEATING OIL COST MORE IN DECEMBER THAN IN OCTOBER AND NOVEMBER. WHILE IT WAS MORE EXPENSIVE, IT WAS AVAILABLE BECAUSE THE PRICE RISE ATTRACTED SUPPLIES FROM OUTSIDE THE AREA - INCLUDING CANADA, VENEZUELA AND THE VIRGIN ISLANDS.

A MAJOR GOAL OF ANY RESPONSIBLE COMPANY IS TO ESTABLISH A SOLID REPUTATION WITH ITS CUSTOMERS, TO PROVIDE RELIABLE PRODUCTS AND SERVICE AT A FAIR PRICE. WE VALUE OUR CUSTOMERS, AND RECOGNIZE THAT THEY HAVE ALTERNATE SUPPLY OPPORTUNITIES. WE HAVE LONG STANDING BUSINESS RELATIONSHIPS WITH OUR CUSTOMERS WHICH WE WOULD NOT JEOPARDIZE FOR SHORT TERM GAIN.

TO FULLY UNDERSTAND AND APPRECIATE THE WORKING OF A COMPETITIVE MARKETPLACE ONE NEED ONLY LOOK AT THE CURRENT SUPPLY/DEMAND PRICE RELATIONSHIP. WITH TEMPERATURES RETURNING TO MORE NORMAL LEVELS AND DEMAND FALLING, THE PRICE OF HEATING OIL HAS DROPPED.

FOR EXAMPLE, THROUGH THE FIRST 10 DAYS OF JANUARY IN THE WHOLESALE AND FUTURES MARKET, NEW YORK HARBOR PRICES FOR #2 HEATING OIL HAVE DROPPED BY 18 CENTS PER GALLON, TO ABOUT 73.5 CENTS PER GALLON. FUTURES PRICES FOR FEBRUARY DELIVERY ON THE NYMEX HAVE DROPPED BY ABOUT 12 CENTS PER GALLON SINCE JANUARY 3. IN ONE DAY ALONE WE RECENTLY LOWERED PRICES AT SOME OF OUR TERMINALS BY AS MUCH AS 13 CENTS PER GALLON.

FROM DECEMBER 23 TO DECEMBER 30, WE PURCHASED 24 MILLION GALLONS OF HEATING OIL AT AN AVERAGE PRICE OF 95 CENTS PER GALLON FOR THE NORTHEAST REGION. MUCH OF THAT PRODUCT HAS NOT YET WORKED ITS WAY THROUGH OUR DISTRIBUTION SYSTEM AND WITH CURRENT PRICES IN THE RANGE OF 76 CENTS TO 86 CENTS PER GALLON, WE ANTICIPATE A SIGNIFICANT LOSS ON THESE VOLUMES.

NOT SURPRISINGLY, NO-ONE IS ASKING WHY PRICES HAVE DROPPED OR EXPRESSING CONCERN THAT WE MAY HAVE TO SELL PRODUCT FOR LESS THAN ITS PURCHASE PRICE.

THAT'S A FUNCTION OF SUPPLY AND DEMAND AND WE ACCEPT THE WORKING OF A COMPETITIVE MARKET SYSTEM.

WHEN COMPETITIVE MARKETS ARE OPERATING FREELY, CONSUMER NEEDS ARE MET AT THE LOWEST COST. ALTHOUGH THERE IS A STRONG TEMPTATION TO INTERFERE WITH THE WORKINGS OF THE FREE MARKET DURING A PERIOD OF RISING PRICES, WE HAVE SEEN IN THE PAST HOW ALLOCATION SYSTEMS, RATIONING OR PRICE CONTROLS HAVE EXACERBATED SHORTAGES, INCREASED PRICES AND RESULTED IN INEQUITIES GREATER THAN THOSE UNDER A COMPETITIVE MARKET.

I SINCERELY HOPE THAT I HAVE BEEN ABLE TO SHED SOME LIGHT ONTO A SUBJECT THAT IS SO OFTEN MISUNDERSTOOD BY SO MANY PEOPLE. I THANK YOU FOR YOUR ATTENTION AND FOR GIVING ME THIS OPPORTUNITY TO SHARE THIS INFORMATION WITH YOU.

PETROLEUM MARKETERS ASSOCIATION OF AMERICA

STATEMENT OF

ROBERT W. WESSON

William F. Wesson, Inc.
On Behalf of
The Petroleum Marketers Association of America

BEFORE THE

COMMITTEE ON GOVERNEMTAL AFFAIRS

U. S. SENATE

Washington, D.C.

ON

RECENT HEATING OIL PRICE INCREASES

January 16, 1990

1120 VERMONT AVENUE, NW • SUITE 1130 • WASHINGTON DC 20005 • (202) 331-1198

PETROLEUM MARKETERS ASSOCIATION OF AMERICA
STATISTICAL QUICK REFERENCE SHEET
1987 DATA

NUMBER OF MARKETERS REPRESENTED		10,481
TOTAL VOLUME OF REFINED PRODUCTS SOLD		92 BILLION GALLONS
EMPLOYMENT		241,902
Full Time Employment		201,262
Part Time Employment		40,640
PERCENT OF U.S. TOTAL REFINED PRODUCTS		36.0%
Motor Gasoline		54.8%
Distillate Fuel Oil		58.5%
NUMBER OF MARKETERS BY PRODUCT	NUMBER	% of TOTAL
Heating Fuels Only	1,362	13%
Motor Fuels Only	3,878	37%
Both Heating & Motor Fuels	5,241	50%
TOTAL	10,481	100%
TOTAL MOTOR FUELS RETAIL FACILITIES SUPPLIED		94,329
TOTAL MOTOR FUELS RETAIL FACILITIES OWNED		41,976
TOTAL NUMBER OF CONVENIENCE STORES OWNED		18,875
HEATING FUELS DISTRIBUTION CHANNELS		% of PRODUCT
Residential		75%
Commercial		14%
Other Fuel Oil Marketers		6%
Industrial		4%
Other		1%
MOTOR FUELS DISTRIBUTION CHANNELS		% of PRODUCT
Direct Owned & Operated		36%
Lessee Dealer		14%
Open Dealer		22%
Bulk End Users		23%
Others		5%
BULK STORAGE CAPACITY		1.7 BILLION GALLONS
NUMBER OF BULK STORAGE FACILITIES		10,500

Source: Petroleum Marketers Association of America

MEMBERS OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

The Petroleum Marketers Association of America (PMAA) represents the independent petroleum marketers who are members of these state and regional trade associations:

- Alabama Oilmen's Association
- Arizona Petroleum Marketers Association
- Arkansas Oil Marketers Association, Inc.
- California Independent Oil Marketers Association
- Colorado Petroleum Marketers Association
- Independent Connecticut Petroleum Association
- Florida Petroleum Marketers Association
- Georgia Oilmen's Association
- Idaho Oil Marketers Association
- Illinois Petroleum Marketers Association
- Indiana Oil Marketers Association, Inc.
- Petroleum Marketers of Iowa
- Kansas Oil Marketers Association
- Kentucky Petroleum Marketers Association
- Louisiana Oil Marketers Association
- Maine Oil Dealers Association
- Michigan Petroleum Association
- Mid-Atlantic Petroleum Distributors Association, Inc.
- Mississippi Petroleum Marketers Association
- Missouri Oil Jobbers Association
- Montana Petroleum Marketers Association
- Nebraska Petroleum Marketers, Inc.
- Nevada Petroleum Marketers Association
- Independent Oilmen's Association of New England
- Fuel Merchants Association of New Jersey
- New Mexico Petroleum Marketers Association
- Empire State Petroleum Association
- North Carolina Petroleum Marketers Association
- Northwest Petroleum Association
- Ohio Petroleum Marketers Association
- Oklahoma Oil Marketers Association
- Oregon Petroleum Marketers Association
- Pennsylvania Petroleum Association, Inc.
- Petroleum Marketers Association of Wisconsin
- South Carolina Oil Jobbers Association
- South Dakota Petroleum Marketers Association
- Tennessee Oil Marketers Association
- Texas Oil Marketers Association
- Virginia Petroleum Jobbers Association
- Washington Oil Marketers Association
- Western Petroleum Marketers Association
- West Virginia Petroleum Marketers Association
- Wyoming Petroleum Marketers Association

The Petroleum Marketers Association of America is located at 1120 Vermont Avenue, N.W., Suite 1130, Washington, D.C. 20005. Telephone: (202) 331-1198. Fax: (202) 467-6330

Good morning, Mr. Chairman and members of the committee. I appreciate the opportunity to appear before the committee to discuss a major area of concern to not only consumers but to heating oil marketers as well. My name is Robert Wesson and I am President of William F. Wesson, Inc., a petroleum marketing company that has served the fuel needs of the Waterbury, Connecticut area for over 50 years. I am appearing today on behalf of the Petroleum Marketers Association of America (PMAA), a federation of 43 state and regional trade associations representing nearly 11000 small and independent marketers. Collectively these marketers sell over half of the gasoline, three-quarters of the home heating oil and sixty percent of the diesel fuel consumed in the U.S. annually. I currently serve as the Senior Vice President of PMAA. Previously I have served as Chairman of the Board of the New England Fuel Institute and as President of the Connecticut Independent Petroleum Marketers Association.

The subject of this hearing today is one of great concern to me and to my fellow heating oil marketers across the country. Since the middle of November we have witnessed unprecedented price increases for home heating oil. I understand fuel used as diesel fuel has experienced similar increases. These price increases are a source of anger and frustration not only for consumers but also for the thousands of heating oil retailers represented by PMAA.

As a trade association, PMAA is unable, under the anti-trust laws, to track current pricing information. However, I am more than happy to share with the subcommittee historic data relating to my individual situation as an illustration of what prices have really done since the beginning of December. I can also share the information that is available from published sources.

Why Have Prices Increased?

The question on everyone's mind is why have the prices increased so rapidly over such a short period of time. As a heating oil retailer, I am unable to offer expert advice on the reasons for the price spike. From comments I've heard and information PMAA has received, there appear to be several factors that have contributed to the price rise. First and foremost has been the dramatic increase in demand for distillate fuels. According to the DOE, the increase in demand from November to December was over one million barrels per day. The level of demand for distillate fuels in December- 4.1 million barrels per day- was the highest level of monthly demand for distillates since January, 1981. Of course, a major factor in the demand increase was the weather. From what I understand, the month of December was the coldest since the National Weather Service began keeping records. Not only was the weather abnormally cold here but also in Europe as well. This increased demand for heating fuels on a global basis and affected both the supply and price of imported heating oil into the United States.

Another demand factor for oil was created by the entrance into the market of interruptible natural gas customers. These customers include utility,industrial and commercial users of natural gas who have dual fueling capability. Gas utilities will generally sign up such customers and supply them with natural gas at discount prices with the understanding that during periods of peak demands supply can be interrupted. In this way gas utilities have the best of both worlds. They are able to market their surplus natural gas during periods of low demand while placing those same customers in the oil market when supplies tighten. This increases both the demand for and the price of oil to oil consumers.

PMAA believes utilities should be held accountable for all of their customers the year round and until they are, they should be limited in their ability to sign up new accounts. Otherwise, residential oil users are forced to subsidize such policies.

In addition, if interruptible customers are going to be allowed there should be some policy direction regarding the amount of oil storage capacity they must maintain. The lack of adequate storage by large interruptible customers means that oil deliveries to them must be done frequently oftentimes interrupting the normal distribution patterns a company may have.

It is estimated that as much as 50 percent of the gas moving through U.S. pipelines is shipped on so-called interruptible contracts. One state public service commissioner was quoted as saying that almost every interruptible customer has probably already been interrupted. This has had a dramatic impact on the demand for oil. It is estimated that as much as 20 percent of the increased demand for distillate fuel in December comes from non-traditional users.

The cold weather had an impact not only in increasing the demand for heating oil but also in affecting the availability of supply. This occurred because of the bitterly cold weather in much of the southwest where most of our domestic refining centers are located. Unaccustomed to such cold several refineries had operational problems that affected their ability to produce fuel. In addition, there were problems in some parts of the country with delivery by barge resulting from ice on rivers.

Another factor is that the level of heating oil inventories at both primary and secondary levels were insufficient to meet the sudden surge in demand caused by the severe weather. The industry has been criticized for not being better prepared by having more oil in storage. Certainly had I and my fellow marketers known what the weather was going to be like, we would have stored more oil.

Unfortunately, our only guide is experience. What has been our demand during previous winters? Given the volatility in price for heating oil and other petroleum products and the substantial costs for storage it is not economically prudent to put more oil in storage than one can reasonably anticipate needing.

A final point I would note is the inevitable sense of panic that pervades the market whenever supply is tight and prices are on the rise. In its simplest form it is the home heating oil consumer who either fears that he may run out of oil or that the price is going to go ever higher and thus requests a delivery of oil to top off his tank. The effect of every heating oil tank in this country being topped off has a similar impact on supply as did the efforts of motorists to top off the gasoline tanks during the embargo days. But, that same panic can and does pervade the wholesale market as well causing traders, brokers, wholesalers and retailers to attempt to stockpile supplies. Such reactions also have a psychological effect on traders on the New York Mercantile Exchange thus driving up prices there. A price runup on the NYMEX will generally result in an increase in the current spot market and the vicious circle continues.

Who Is Making Money?

After, "Why have the prices gone up?", "Who is making the money?" is the next most asked question by the general public. I generally respond by first saying who is not making excessive profits off the price spike and that is the heating oil retailer. Since the middle of November, my wholesale cost has increased 59 cents per gallon while my retail price has increased by 47 cents. I have included as Attachment 1 a comparison of my average wholesale costs and my retail prices for the period November 15 - December 31, 1989. As you can see, I did not pass through the full wholesale cost increases.

Some public information is available in this area. Looking at three typical suppliers in New Jersey listed in the Platts Oilgram Price Report, one finds that the average wholesale price went from 62.1 cents per gallon as of November 30, 1989, to $1.118 per gallon on December 30, 1989. On average, the wholesale price went up 49.7 cents per gallon. The retail price as tracked by the **Journal of Commerce** in New Jersey increased by an average of 41.5 cents. I understand that numbers developed by the New York State energy office show that wholesale prices went up over 41 cents per gallon while retail prices rose only 28.9 cents during the month of December.

Not only have I and most other retailers not passed through the full wholesale price increases, I have not passed through any of my increased costs of doing business. These increases include, among other things, higher labor costs associated with overtime for my drivers and dispatchers as well as higher transportation costs. I am actually making less per gallon on the price of oil today than I was in the middle of November. While I am unable to offer any national data on this subject, the anecdotal reports that PMAA has received from other marketers would indicate that my situation tends to be the rule and not the exception.

I contrast the situation with heating oil retailers with that of their suppliers, many of which are major oil companies. There is no question that refiners have substantially increased their margins during the month of December. The level of this increase can best be addressed by other witnesses or when DOE publishes its price information. I believe these profits will also be reflected in the forth quarter financial statements which will be issued later this month.

These profits appear to be the result of certain companies being in a position to take advantage of many of the factors cited above. I fully anticipate with the weather stabilizing and the influx of supplies that the price will begin to fall. In fact, I can report that my wholesale price has already begun to decrease.

This is important particularly since some have suggested that perhaps the government should attempt to reregulate the price of oil. This would be a tragic mistake. Our experience in the 1970's taught us that the government is poor allocator of scarce resources. I would also remind the subcommittee that even though our free market system allows the type of blips that we have witnessed over the past few weeks it also has allowed prices in general to be lower in the decade of the 80's than they were in the decade of the 70's.

Steps Which Might Be Taken:

In a December 28, 1989, letter to Secretary of Energy Watkins, PMAA outlined several steps it thought the Department of Energy might take to address the problems being faced. In the short term we called on DOE to continue to monitor both the price and supply of heating oil, specifically on the flow of product from the refineries to the terminals; act to reassure consumers that an emergency does not exist and that there is no need for such panic reactions as topping off heating oil tanks; and that the department examine all regulatory restrictions which may hinder the free flow of product from refineries to the terminals and to lift all such restrictions on a temporary basis which do not jeopardize human health and safety.

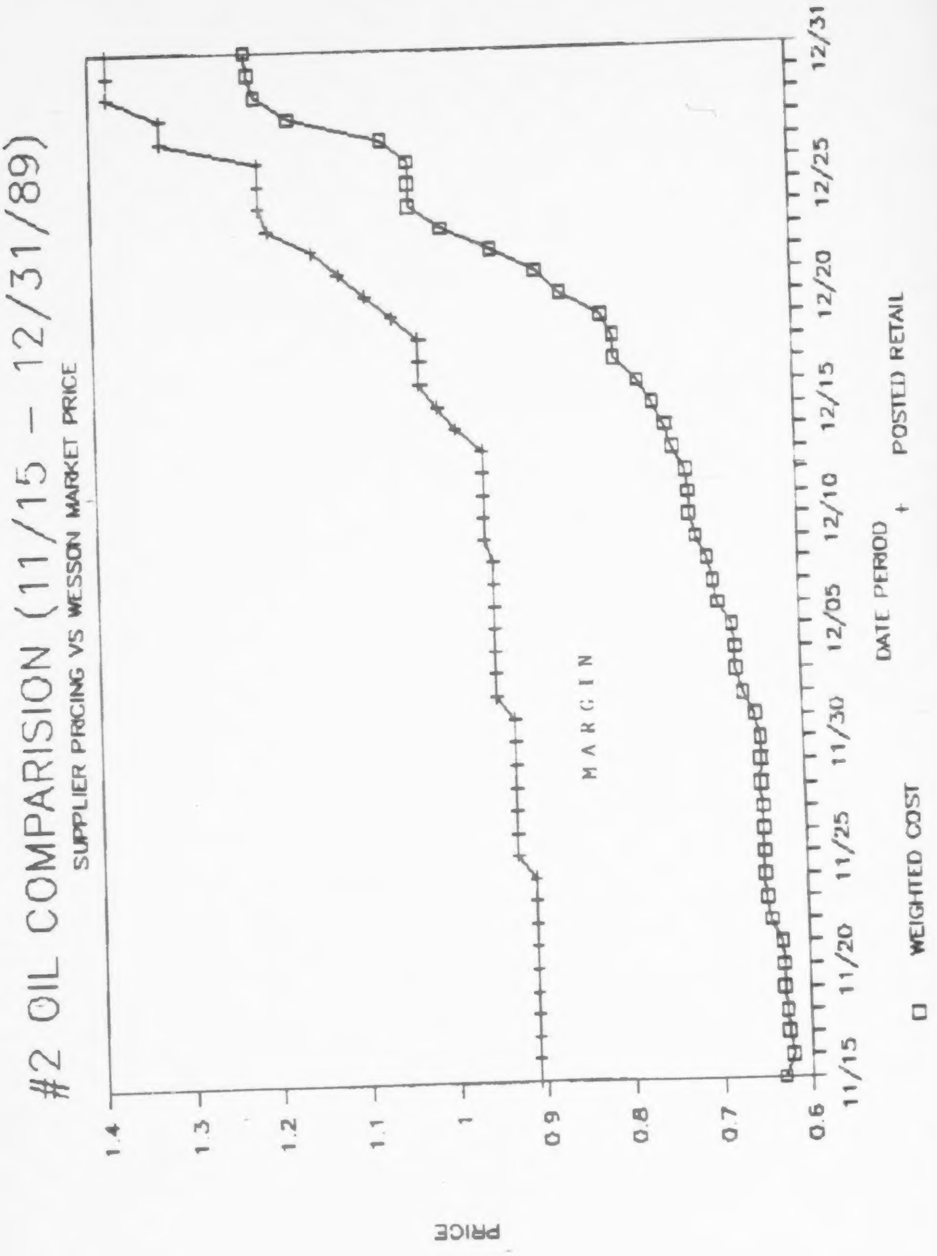
We also offered one long term suggestion that relates directly to Chairman Sharp's proposed legislation on the strategic petroleum reserve, HR 3193. Our suggestion to Admiral Watkins was that the DOE examine the desirability of establishing recommended levels of inventories at the beginning of the heating season for both primary and secondary storage of heating fuel. PMAA believes this can be accomplished by a regional storage of petroleum products as part of the Strategic Petroleum Reserve (SPR) as outlined in Chairman Sharp's bill. However, there would need to be clear criteria for triggering such a product reserve separate from the criteria for triggering the crude oil SPR. There would also need to be some mechanism to insure that the product was turned over regularly to maintain its quality. Finally, PMAA offers its support of these approaches on the basis that petroleum would not be further taxed to fund such SPR expansion. PMAA remains opposed to the enactment of any sort of oil import fee, any increase in the existing 9.1 cents per gallon federal excise tax on gasoline, or the 15.1 cents per gallon tax on diesel fuel.

Another recommendation would be the examination of the impact that natural gas curtailments are having on oil supplies and price. Accompanying such examination should be concrete recommendations restricting the ability of gas utilities to sign up new customers unless they can reasonably anticipate that there will be sufficient gas during periods of peak demand to meet those customers' needs.

A final suggestion PMAA would make is that Congress fully fund the low income energy assistance program to at least the levels available in previous years. As a result of the extremely cold weather and the increased energy costs Congress may wish to consider an even higher level of funding for the program. A copy of PMAA's January 11 letter to President Bush urging his support for such funding is included as Attachment 2.

Thank you Mr. Chairman for the opportunity to appear today and I look forward to responding to any questions that you or other members of the committee may have.

Attachment 1



#2 OIL COMPARISION (11/15 – 12/31/89)

SUPPLIER PRICING VS WESSON MARKET PRICE

Attachment 2

PMAA

PETROLEUM MARKETERS ASSOCIATION OF AMERICA
1120 VERMONT AVE. NW • SUITE 1130 • WASHINGTON, DC 20005 • (202) 331-1198

January 11, 1990

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

With the winter less than half over, many parts of the country have already experienced the coldest weather in recent memory. Unprecedented low temperatures have been reported throughout the United States. In some areas it has been the coldest December since the National Weather Service began keeping records. As the temperature has plummeted, the costs of all home heating fuels-heating oil, natural gas, electricity, and propane-have skyrocketed.

Under your leadership, the Department of Energy has been monitoring the situation and has made recommendations on actions the government might take to insure that adequate supplies reach those areas of the country with the greatest need on a timely basis. The thousands of heating oil marketers represented by the Petroleum Marketers Association of America (PMAA) appreciate the efforts of your administration in this regard.

We would, however, recommend one additional action. The severe cold could not have been predicted by anyone, not by fuel suppliers and certainly not by your administration when it developed the FY 1990 budget. As a result, the amount of money included in the FY 90 budget for low income energy assistance programs is clearly going to be insufficient to deal with those families in need as a result of the extreme cold. PMAA, therefore, urges that you recommend to Congress an urgent supplemental appropriation designed to increase the amount of funds currently available for low income energy assistance.

Efforts to help the low income pay their heating bills are a good example of how your "thousand points of light" can work. Fuel funds donated by private sources through their fuel suppliers help the needy in many communities across the nation. But, these sources, coupled with the existing federal monies, will still be insufficient to meet the needs of the poor this winter.

Heating oil dealers represented by PMAA have been on the front line in dealing with consumers during this crisis. Because they are small businesses active in the local community and because they deliver fuel directly to the homes of their neighbors, they are able to see first hand the human toll that the extreme cold and the tremendous price increases have had on a number of low income families.

In many instances, these dealers have absorbed a portion of the wholesale price increase charged them by their suppliers. For example, recent data collected by the states of New York and New Jersey show that for the month of December that heating oil retailers did not pass through 8-10 cents of the wholesale price hike. In addition, retailers have also absorbed virtually all of their increased operating costs resulting from the cold weather. These expenses include higher labor and transportation costs.

Mr. President, the marketers represented by PMAA have consistently supported many of your initiatives during your first year in office. We commend you for your leadership and your foresight. We hope you will agree that the situation facing many low income Americans today relative to the sudden rise in home heating costs merits a special supplemental appropriation as soon as possible.

Sincerely,

Phillip R. Chisholm

Phillip R. Chisholm
Executive Vice President

PC:cp

The Impact of Cold Weather in December 1989 on Heating Oil Prices

Statement of
Philip K. Verleger, Jr.
Visiting Fellow
Institute for International Economics and
Senior Consultant, Charles River Associates

before

Governmental Affairs Committee of
The United States Senate

January 16, 1990

Mr. Chairman, members of the subcommittee, I am pleased to appear today to discuss the recent rise and subsequent fall in the price of heating oil. In my testimony today I will try to provide an economic context for these events. In this statement I will make the following points:

> Recent events in the heating oil market can be explained by changes that have occurred in the way the oil industry does business. Oil has become a commodity to the benefit of consumers. This development means that prices move much more rapidly than in the past. Further, movements up and down in response to unexpected shifts in supply or demand are larger. Events in December illustrate this phenomenon.
>
> The increase in prices resulted from the prolonged period of extremely cold weather experienced in the United States between November 28, 1989 and December 30, 1989.
>
> The rise in prices was further exacerbated by the simultaneous occurrence of cold weather on both the east coast and the U.S. Gulf coast. This double blow appears to have been a unique event in the post war market.
>
> The expiration of the January heating oil futures contract at the very end of the cold spell also contributed to the price volatility. Unfortunately, the January contract expired after thirty days of cold weather and after heating oil production had been lost. Thus, the normal end of trading volatility in the market was aggravated by the unanticipated increase in demand and the loss of supply.

The spot and futures markets worked as expected, providing incentives to companies to reduce stocks when supplies were tight.

The New York Mercantile Exchange responded to the cold weather in an expeditious and appropriate manner.

The lower than normal level of inventories may have also contributed modestly to the price increase.

It is both inappropriate and impossible to assess margins during this episode. Profits can only be examined by comparing both the gains from the sales of oil and the possible losses on hedges. Further, many firms had recorded substantial losses on their inventories in 1988 and early 1989 when warmer than normal weather depressed prices.

The oil industry was able to meet the unusually high demand despite the extreme conditions that prevailed in both consuming and producing regions and despite obstructions erected by the U.S. Maritime Administration.

It was theoretically possible to have protected consumers from the higher prices experienced during the crisis. Financial instruments offered through the New York Mercantile Exchange and various banks offer a means of "hedging" heating oil costs and buyers could have "locked in" lower prices which would have ameliorated the economic impact of cold weather.

Structural Change

A large part of the explanation for the recent dramatic increase in the price of heating oil may be found in the structural change that occurred in the oil industry during the 1980s. In effect, oil became a commodity and with the transition the system of administered or producers prices was replaced by market related prices. Oil exporting countries were forced to replace posted with market related prices as part of the change. The effect of this shift can be seen in the pricing of Saudi Arabian crude. In the early 80s prices on cargos arriving at refineries on the US Gulf coast were established long before the oil was loaded on a ship or even pumped from the ground. By contrast, prices today are determined from quotes on spot markets, not Saudi fiat, about the time the oil arrives at the refinery.

Suppliers (refiners, distributors, and dealers) have been forced to adopt similar sales mechanisms. When prices weakened, firms have been forced to follow the market or lose sales. Over time, the New York Mercantile Exchange has become the key indicator of the level of prices for heating oil and gasoline, particularly on the east coast. Most, if not all transactions are explicitly or implicitly tied to Merc quotes. Large buyers will often have contracts with several suppliers and shift their business from seller to seller depending on which firm has the best prices. This vicious competitive shopping forces sellers to keep prices in line with Merc quotes.

The extent of this structural change (which I will refer to as "commoditization," a very descriptive, but awkward word) has been greater in the United States than in other countries and retail prices here tend to be more responsive than in other countries. Usually, it has been the consumer, not the oil industry that has benefited. For example, when crude oil prices collapsed, retail prices of gasoline in the United States declined by 38.6 cents per gallon while declining by only 14.4 cents per gallon in West Germany and 32.6 cents per gallon in Britain. Prices did not change at all in France and actually rose by 23 cents per gallon in Japan. (Changes in these four countries are computed holding taxes constant and after adjusting for the decline in the value of the dollar.)

Structural change and the commoditization of oil does, however, expose buyers to greater fluctuations in prices. Commodity markets are traditionally more delicately balanced than producer markets. Allocation of available supplies is accomplished entirely by adjustments in prices. This means that sellers must accept low prices when there is no demand and buyers must pay up during periods of extraordinarily high demand. The volatility of prices makes it very risky to hold stocks.

The increased price volatility that has accompanied the commoditization of petroleum has forced firms in all areas of the oil market to adopt techniques used in other markets. Purchases and sales are now often hedged through offsetting purchases and sales on futures or forward markets. These financial markets permit firms to build inventories in a riskless manner at certain times. When markets are in "contango" (a condition that exists when futures prices exceed cash prices) a refiner or distributor can cover storage costs by selling futures against stocks. Such sales insure the owner of stocks against loss if prices fall. However, the hedge denies the firm the opportunity to profit if prices increase. The firms that hedged their stocks in late 1989 were forced to forego part or all of the profits that might have been made when prices increased in order to assure their continuing financial viability. Further, firms hedging stocks would have incurred a loss if they had not raised their prices when Merc prices increased.

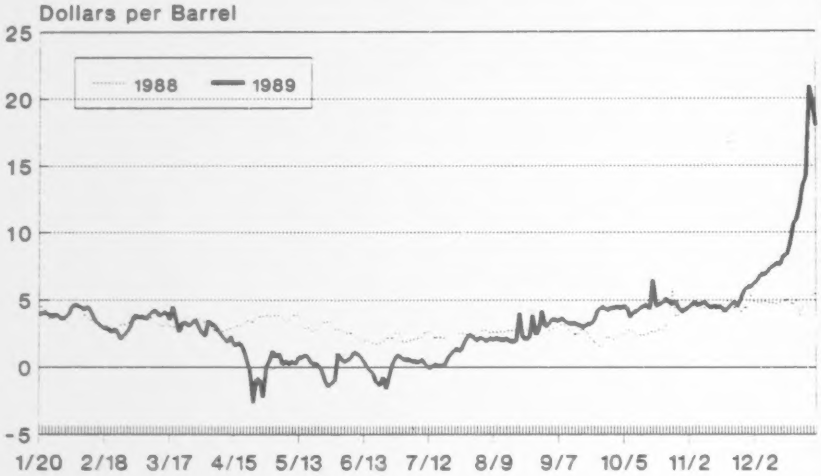
The heating oil market in 1989 offers an excellent example of this phenomenon. Early in the year refiners could not give the product away. For a period of time heating oil even sold for less than crude oil. Then, late in the year, heating oil commanded record premiums over crude. The pattern of prices is captured on Figure 1 which shows the margin between spot heating oil sold in New York Harbor and West Texas Intermediate Crude (WTI) for 1988 and 1989. It may be observed that the margin reached a record level of $ 20/bbl in December. However, it may also be noted that the margin dipped below zero on three occasions during the summer. (Note that due to limitations in the graphics program the data are shown from January 20 through the end of each year.) The spectacular rise in margins at the end of the year only offset the lower margins recorded earlier in 1989. For the year as a whole, margins in 1989 were no different than 1988 ($ 3.29/bbl in 1988 as compared to $ 3.27/bbl in 1989). However, the standard deviation in margins was much greater ($0.97/bbl in 1988 as compared to $3.07 in 1990) suggesting the risks of operation were much higher in 1989.

Refiners responded to the wild fluctuations in margins in precisely the manner that is predicted from economic textbooks. During the summer they cut back on the production of heating oil and disposed wherever they could find a market. Some refiners were forced to export product when prices were low because they could not convince dealer buyers to build stocks while prices were cheap. Both parties made the rational decision at the time because the 3

Figure 1

Margins Between Heating Oil and Crude

Spot New York Heating Oil Less WTI



Computed from Platts data for the period 1/20/88 to 12/31/88 and 1/20/89 to 12/31/89.

cent per gallon spread between the cash price and December futures did not come close to covering the cost of storage.

I will conclude by noting that the development of the commoditized market has contributed to a more volatile and more competitive market. Firms at every stage of production and distribution have been forced to become more competitive. This means that sellers must follow the market down and will obviously follow it up. It also implies that additional inventories will be accumulated only when storage is profitable. Companies that violate these rules court disaster.

The Cold Weather

The increase in prices that occurred during December was primarily caused by the period of extreme cold weather that occurred at that time. Below normal temperatures generally cause the prices of heating fuels to increase, especially during periods of intense cold. According to my analysis, the cold spell was one of the worst of the decade.

Table 1
Periods of Intense Cold Weather during
The 1980s

Date Episode Began	Date Episode Ended	Length	Abnormal Degree Days
November 28, 1989	December 30, 1989	32	341
December 11, 1980	January 19, 1981	39	339
January 8, 1982	January 29, 1982	20	242
January 8, 1985	January 23, 1985	15	116
January 11, 1984	January 23, 1984	13	112
January 26, 1985	February 10, 1985	14	66
February 5, 1983	February 14, 1983	19	49
February 10, 1986	February 19, 1986	7	38

Source: National Oceanographic and Atmospheric Agency.
Measurements taken at Central Park in New York City.

Based on an analysis of these prior episodes I would estimate that the cold weather created an unexpected demand for heating oil of approximately 17.5 million barrels (560 thousand barrels a day) in the traditional temperature sensitive sector of the market. This incremental demand was augmented by increased usage by non traditional consumers such as utilities which added an additional 150,000 mbd to demand according to testimony presented to the House Subcommittee on Energy and Power by John Lichtblau. In the abstract world favored by economists, these increased demands represented a shift to the right of the demand curve. Other things being equal, prices should have increased.

But other things were not equal. Mother nature elected to perform a unique experiment by simultaneously freezing both the east coast and the U.S. Gulf coast. Houston recorded 228 abnormal degree days and Shreveport recorded 237 abnormal degree days during December with the very intense cold occurring after December 15 according to DOE's Weekly Petroleum Status Report. Several refineries were forced to close or drastically curtail operations. At one point all five refineries belonging to a large major were shut down. Curtailed refining operations probably reduced output of heating oil by 6 million barrels or 200 thousand barrels a day.

The loss of supply is represented in the economists' abstract world by a leftward shift of the supply curve. Absent any change in demand such a shift will also cause an increase in price. When combined with the higher demand one would expect an enormous increase in prices - which is precisely what was observed.

The loss of supply and the increased usage by utilities effectively magnified the impact of the cold weather by roughly 60 percent. The market responded as if temperatures were 17 degrees below normal rather than 10 degrees below normal. Some very simple and preliminary econometric analyses I have performed appear to predict that an incident of this magnitude - that is an episode where temperatures were 17 degrees below normal - should have caused prices to increase to about $ 1.00 per gallon. Surprisingly, given the complicated nature of the problem, prices actually increased to that level by December 29. The econometric analysis also appears to predict that prices would have only increased to about 80 cents per gallon if the cold weather had not affected refinery operations and created the unexpected utility demand.

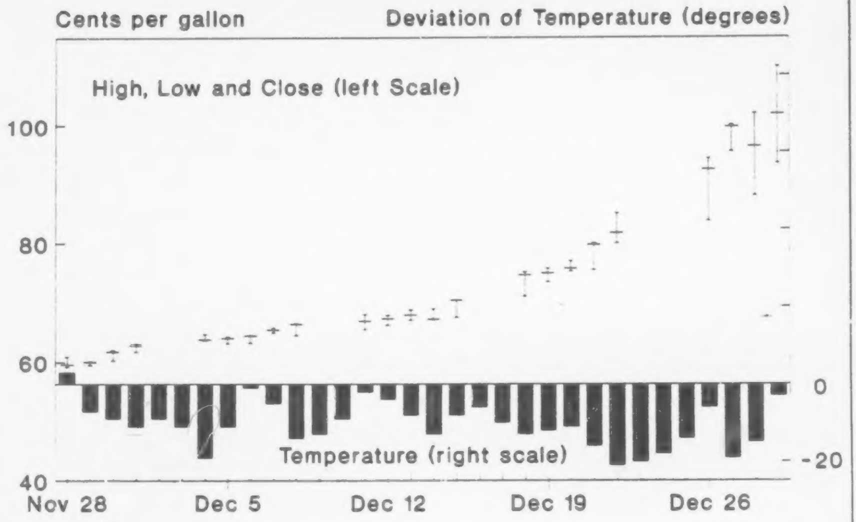
The day to day pattern of prices seem to confirm this conclusion. Futures prices increased steadily, but in a fairly narrow range during the first three weeks of December, peaking at 81.74 cents a gallon on December 22. Then, news of the loss in supply plus continued cold caused prices to increase by a further 20 cents per gallon in the following week.

Figure 2 provides further evidence to support this conclusion. It compares the day to day increase in prices with the pattern of abnormal temperatures. The top part of Figure 2 shows the low, average and settling price for the January heating oil futures contract while the bottom portion shows the deviation of temperatures from the normal level (which averaged 10.6 degrees). As with many past episodes of cold weather it may be noted that the largest increases were associated with the days of most extreme cold weather, particularly when they occurred consecutively. Further, the particularly large price increase observed on the first day of trading after Christmas was similar to the market behavior observed during earlier episodes. Empirical research on weather sensitive commodity markets has identified a clear "Monday Morning effect" as trade adjusts to new information that developed over the weekend.

Figure 2

Comparison of January Futures Prices

With Temperature Deviations, December 89



Source: New York Mercantile Exchange and New York Times.

The Role of the New York Mercantile Exchange

Some commentators have suggested that some of the blame for the increase in prices during December should be assigned to the New York Mercantile Exchange. For example, Joan Claybrook, President of Public Citizen, asserted that the "speculator driven market" greatly magnifies "the price impact of even minor supply disruptions" in her testimony to the House Subcommittee on Energy and Power on January 9, 1990. (In the process Ms. Claybrook also seriously distorted conclusions of a study I am preparing on the behavior of oil markets during crises.)

The facts contradict these conclusions. According to data prepared by the Commodity Futures Trading Commission, an agency of the U.S. government, 70 percent of the short open interest in the futures market was held by commercial users as of November 30, 1989. At that time commercial users (which the CFTC defines as traders that regularly use futures for hedging) accounted for 71,216 of the 102,093 short sales. Many of these sales had been made for insurance purposes by refiners, terminal operators and dealers who were attempting to avoid financial losses if prices declined.

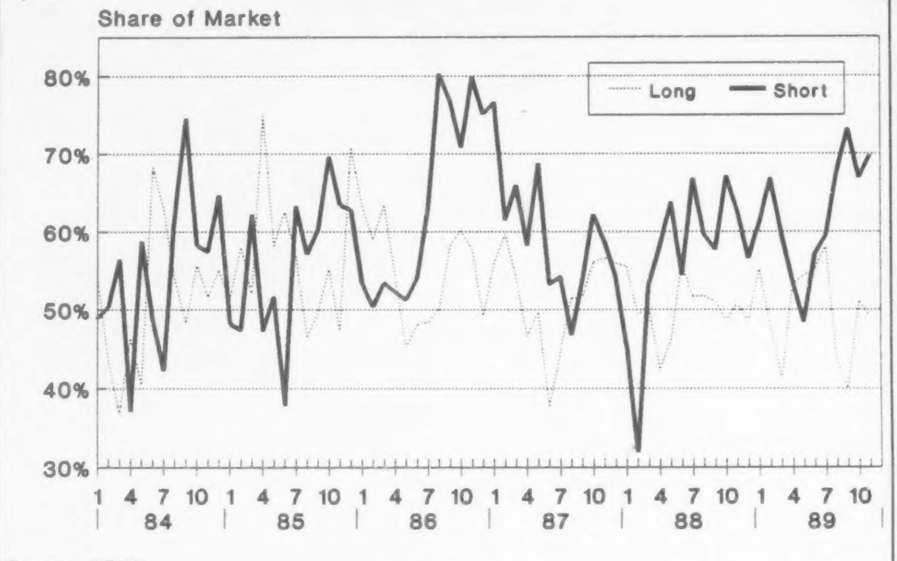
Many of these sales were matched by non commercial buyers. The CFTC data report that 51 percent of the long positions fell into the "non reporting" or "non commercial" categories. Non commercial traders - market participants that might legitimately be labeled as speculators - held 19 percent of the long positions while non reporting traders held the remaining 38 percent. Traders fall in this last category if they hold fewer than 150 contracts. Both small commercial firms (such as prudent dealers and terminal operators) as well as small speculators are put into the non reporting category.

A six year trend in the commercial share of open interest in heating oil futures is shown on Figure 3. Inspection of this graph shows that the share of the market held by commercials at the end of November comparable to prior years. Thus, the assertions that speculators "magnified" the price increase seems unwarranted - at least through the end of November.

Figure 3

Commercial Share of Open Interest in

Heating Oil Futures



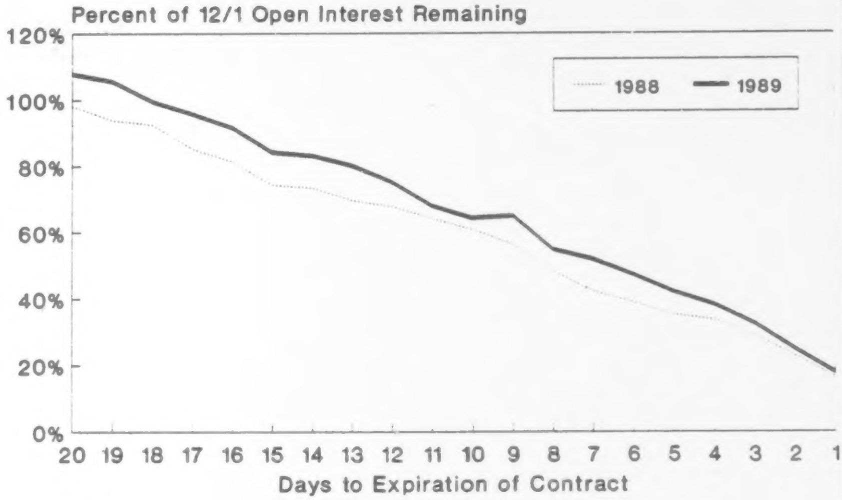
Source: CFTC

The evidence would indicate that the increase during December was also not caused by speculative buying on the futures market. The liquidation pattern for the January contract during December also shows no irregularity. Open interest declined steadily through the month following the pattern observed in 1988 (see Figure 4). This pattern of liquidation implies that traders liquidated their positions at the same rate as they had in prior years. In short, the publicly available data today indicate that the futures market performed normally.

Figure 4

Liquidation of December HO Contract

Percent of Open Interest Remaining



Source: NYMEX
Graph shows open interest on a given day
as percent of 12/1 open interest.

Inventories

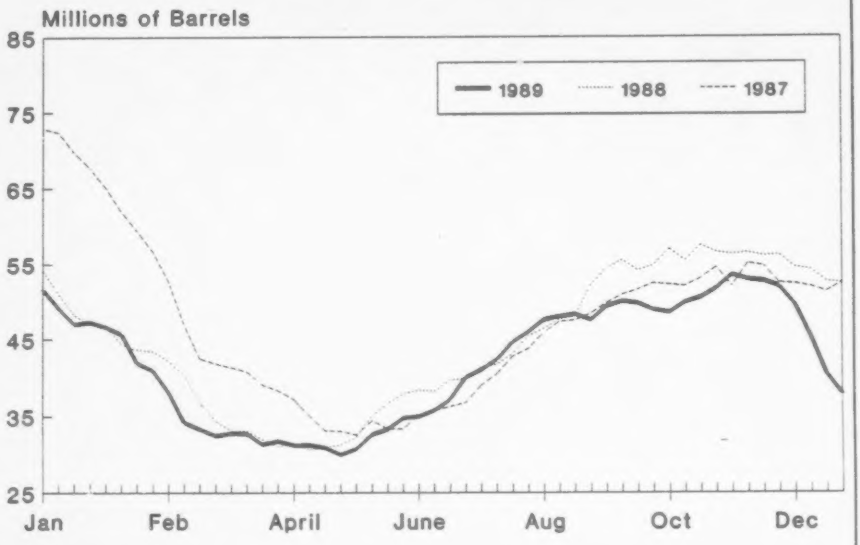
It is clear that the industry started with low inventories when the cold weather arrived. At the end of November immediately available stocks held in primary storage facilities on the east coast were approximately 4 million barrels (8 percent) below 1988 levels (see Figure 5). It should also be observed, however, that stock levels on December 1 were roughly equal to stock levels at the same time in 1987.

The low level of stocks undoubtedly contributed to the increase in prices. Research on the behavior of commodity markets

Figure 4

Distillate Stocks Held in East Coast

Primary Storage Facilities (PADD I)



Source: API

has shown that there are "nonlinearities" in what are described as price reaction functions. As a result, prices of a commodity will rise at a rate that is far in excess of the increase predicted by any type of model when stocks fall below this level. This type of behavior has been noted frequently in agricultural and metals markets but less frequently in energy markets.

These results suggest that some portion of the price increase might have been avoided had firms held larger stocks. Recognizing this fact, many knowledgeable observers of the industry have concluded that policies should be adopted at the federal or state level requiring firms to hold stocks in amounts that would be sufficient to avoid a future repetition of the December episode. Congressman Sharp has, for example, cited the recent price increases as further justification for a regional industry reserve.

However, it would be a mistake to impose an inventory requirement on the industry solely on the conclusion that the low level of stocks caused the recent price increase. First, it is not at all clear that such a requirement could be enforced. Second, the costs of holding such stocks would ultimately be passed on to consumers. Third, ~~there~~ the mechanism to encourage stock holding already exists.

Imposition of a mandatory stock holding requirement on the industry is probably infeasible because stocks are fungible. Empirical and theoretical research indicates, for example, that private stocks would be reduced if the federal government were to build a regional SPR. Other equally undesirable types of substitution would occur if the requirement were imposed on private firms. In short, imposition of a stockholding requirement won't work.

Second, attempts to require firms to hold stocks will undoubtedly increase consumer costs. The monthly cost of storing a gallon of heating oil is between two and four cents per gallon. These costs would eventually be recovered from consumers either through direct pass through or, if market conditions initially prevent sellers from passing on higher costs, through reduced competition as marginal firms that are unable to absorb the higher costs are forced to shut down.

Third, there is no need to impose inventory requirements. Mechanisms to achieve stable prices are already available to terminal operators, distributors and consumers. The record increase in prices would have been smaller had these instruments been widely used.

Stabilization of Costs with Futures

There was no need for the per gallon price paid by consumers to increase in December. Financial mechanisms exist today that allow oil buyers lock in the cost of heating oil for an entire season. For example, commercial buyers could have locked in oil for delivery in December and January at 50 cents per gallon last July. Unfortunately, only a few suppliers offer their consumers this option and few customers take advantage of the opportunity. (One large Connecticut firm advises me that fewer than ten percent of its customers take advantage of its offer to establish fixed prices for a six month period.)

This type of contract is attractive because it provides an economic incentive to build inventories in the fall before the heating oil season starts. Creation of a demand for December, January and February oil in September would, for example, offer a financial incentive to increase stocks by driving prices of winter month futures contracts above cash prices. Aggressive suppliers would seize this opportunity to build market share by increasing their stocks and selling futures.

There are, unfortunately, two major impediments to the adoption of fixed price contracts. First, consumers have traditionally been unwilling to sacrifice their opportunity to buy at lower prices in the future. Second, many distributors and dealers have been unwilling to develop the additional systems required to make this plan work.

Consumer resistance represents a fundamental problem. Acceptance of this type of contract would require that consumers agree to pay a specific price per gallon at the time they signed a contract. They would be obligated to buy a specified volume from a seller at the agreed upon price even~~t~~ if prices later declined. Until recently most consumers would have viewed such an agreement as a bad bet.

Distributor resistance to such proposals could also be substantial since they would be required to develop additional financial systems to manage the paperwork and financial systems to offer such contracts. Further, the distributors would have to either construct facilities to hold the additional stocks, contract for storage of the stocks, contract for the oil, or take long positions in the futures market.

I believe that implementation of this type of scheme offers consumers the best opportunity - other than increased conservation by improved insulation - to control energy costs. However, the concept is quite complex. Its introduction would require the cooperation of firms in all sectors of the energy industry as well as an intensive educational effort on the part of state energy offices.

Industry Profits

I would like to conclude by commenting on the issue of profits that may have been made during the December episode. It has been asserted that many companies earned "excessive profits" in December. Frankly, I do not understand how such assertions can be proven.

The problem is that profits in one activity are often offset by losses taken in a second. The widespread use of hedging means that profits made in the physical market were probably lost in the futures market. The statistics on the position of commercials in the futures market cited above suggest that the industry was short a net of 20 million barrels on the futures market probably against physical stocks. These commercials would have lost almost $ 500 million on their position in the futures market if the short was maintained through December. These losses, if they were realized, would have been transferred outside the industry.

It is also incorrect to examine margins at one specific point of time. As I noted above, margins for all of 1989 were 3 cents less than margins for 1988 because large losses on heating oil were recorded during the summer.

Finally, it is a mistake to attempt to limit the profits that can be made in these markets, particularly by speculators. Speculation through the purchase of futures contracts provides the risk capital (insurance) that enables the oil industry to increase stocks above levels that would otherwise be held. Attempts to limit such speculation, if successful, would cause stocks to decrease and probably exacerbate the fluctuation in prices.

Conclusion

My testimony can be summarized as follows. First, the increase in prices was within the expected range given the length and severity of the weather, low levels of stocks, the loss of refinery capacity on the Gulf coast and the unexpected demand from utilities. Second, the futures market did not contribute to the price increase. Third, attempts to identify the firms that made excess profits are both impossible and inappropriate. Fourth, it is possible for consumers to protect themselves against this type of price increase. Fifth, stocks probably would have been higher and the price increase lower had consumers protected themselves against price increases.

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TESTIMONY TO U.S. SENATE GOVERNMENT AFFAIRS COMMITTEE

RUTHERFORD S. POATS
DIRECTOR OF RESEARCH

JANUARY 16, 1990

INTRODUCTION

Mr. Chairman, Committee members and staff, thank you for the opportunity to testify today. My name is Rutherford S. Poats. I am the Director of Research at Energy Futures Group, Inc., a Bethesda, Maryland energy consulting firm specializing in the analysis of oil and gas pricing, market structures and related commercial practices. EFG has consulted with a fairly diverse spectrum of end-users, marketers, distributors, refiners and producers of oil and gas, as well as with several federal, state and local government entities. As a result, we hope to bring a balanced and, hopefully, broader view of the causes, problems and potential solutions discussed in these and the related House Energy and Commerce Subcommittee hearings.

The petroleum product market pricing and supply issues addressed today are, of course, timely and of immediate concern to affected consumers, industry and government officials. The combination of extreme cold weather and related supply limitations, as well as a series of events in the international market, can be identified as the driving forces behind December 1989's unprecedented heating oil price spike. This coincidence of recent events is unlikely to be repeated, yet the industry's structural and commercial conditions which may have contributed to the severity and rapidity of the price movements are, in my opinion, likely to increase the probability of product-led price spikes in the foreseeable future. In particular, I would point to an increasingly stressed U.S. capacity to refine light petroleum products in the volume and quality needed to bridge temporary demand or supply distortions. Secondarily, I would note that the increasing reliance on transparent spot or futures market pricing mechanisms, resulting from increased industry competition and restructuring over the past decade, has created a price environment which reacts immediately to worldwide events causing greater short-term price volatility than was the case 5-to-10 years ago.

Nonetheless, several offsetting factors should be noted:

- First, over most of the last 10 years consumers have largely enjoyed the benefits of worldwide industry competition and reduced federal government regulation. While industry competition and reduced regulation first accentuate market imbalances, they also correct these imbalances rapidly and tend over the long run to deliver adequate petroleum supplies at prices related to refining and distribution costs.

- Second, in today's relatively open or "deregulated" oil markets, consumers, end-users, state and local government entities can take a more active role in initiating local cooperative action to limit their exposure to this kind of price instability. These groups need to become better informed as to the alternative strategies available and their associated costs and benefits in pursuing a localized market solution to their perceived exposures, rather than relying on a "re-regulated" national solution.

- Finally, while the evidence obtained from price movements, supply limitations and other aspects of recent market behavior will prove informative, a long-term corrective solution should not be based on a one-month market phenomenon. Rather, the underlying weaknesses of our petroleum delivery system should be identified, and better anticipated by industry and consumer alike. Then, market incentives, coupled with very focused federal and state government incentives might be pursued. The focus should be on approaches to relieve stress in the supply system and to deal with uncertainty and its related economic exposure in an inherently unstable marketplace.

I. CAUSAL/FACTORS - A SHORT-TERM FUNDAMENTAL PERSPECTIVE

As noted, this winter's price spike reflects a combination of forces ... some short-term, environmental, unusual and unlikely to be repeated ... some reflective of the U.S. oil industry's economic cycle and increasingly strained supply capabilities, and some reflective of the industry's increasingly commodity-oriented and riskier commercial structure. I would like to focus my initial comments on the shorter-term causal factors which unfolded in December 1989.

As of late November 1989 ...

- New York Harbor spot and near month (January contract) No. 2 fuel oil prices were around $0.62/gallon, following some late month strength induced by a cold wave.
- Apparent distillate fuel oil demand (DFO) and new supply (refinery production + net imports) nationwide were about even with year-earlier levels (approximately 3,200 MB/D).
- Refinery output of DFO, and overall utilization rates were slightly higher than November '88 levels, but net imports were slightly lower.
- Nationwide primary inventories were approximately 7 million barrels (MMB) below year-earlier levels (122 MMB vs. 129), with the East Coast, including all of PAD I, accounting for approximately 4 MMB of this

shortfall (52.0 MMB vs. end-Nov. '88 @ 56.2 MMB). Most of this shortfall was concentrated in the Central Atlantic states (see Table 2).

- OPEC had recently completed a full meeting in which quota increases were granted to major Persian Gulf producers, with the expectation that excess production (averaging nearly 24 MMB/D in November) would be reduced, primarily by Kuwait and the UAE, to a level of 23.0-23.5 MMB/D in December and 22.0-23.0 MMB/D in January 1990.

- On balance, crude oil price expectations were somewhat bearish, given an anticipated 1st quarter 1990 call on OPEC oil of only 21-22 MMB/D, versus an expected output level of about 1MMB/D more.

- On the product side, the relatively low DFO stock situation was discounted somewhat by expectations of adequate crude supplies, a relatively flat 1989 demand growth rate to date, and an expected seasonal increase in both domestic DFO output and net imports.

During December ...

- Refinery output of DFO did increase, but at a slower growth rate than apparent demand due to the boost given demand by the extreme cold (+ 12-15% in December from year earlier levels), and due to the weather and related operating problems experienced late in the month by U.S. Gulf Coast refineries. (See Attachment #1's listing of shut-downs reported by Telerate Energy Service and others.)

- In addition to lagging refinery production, estimated net DFO import levels remained flat from November 1989's relatively low level, and were some 125 MB/D below December 1988 levels. (See Table 1.)
- The combination of relatively low new supply levels and strong weather-induced demand resulted in an increasingly tightening inventory situation as the month progressed (see Table 2).
- On a relative (%) basis, the strain on primary inventories was most pronounced in the New England and Central Atlantic states.
- Even after accounting for the relatively greater reliance of these regions on secondary and tertiary inventories (not included in the levels shown), days' supply readings had reached dangerously low levels by late December, and substantial inter-regional

Table 1

U.S. Distillate Fuel Oil Supply and Demand Trends: November-December 1989 vs. 1988

		Nov. '89 (EFG Ests.)*	vs. Nov. '88 (DOE/EIA Actual)	Dec. '89 (EFG Ests.)*	vs. Dec. '88 (DOE/EIA Actual)
1)	Refinery Production (MB/D)	3010	2909	3325	3068
2)	Net Imports (MB/D)	200	293	200	322
3)	New Supply (1)+(2) (MB/D)	3210	3202	3525	3390
4)	Primary Inventory Change (MB/D)	+20	+20	-500	-170
5)	Apparent Demand (3)+(4) (MB/D)	3190	3182	4025	3560
6)	Ending Primary Stocks (MMB)	122.0	128.8	106.5	123.5
7)	Days' Supply (6)/(5) % Change vs. Year Earlier	38.2 -5.7%	40.5	24.5 -29.4%	34.7

* Estimates based on DOE/EIA and API weekly data.

Table 2

U.S. and PAD I DFO Primary Inventory Trends
December 1988 vs. 1988(1)
(MMB)

END WEEK	U.S. TOTAL			PAD I			NEW ENGLAND			CENTRAL ATLANTIC			LOWER ATLANTIC		
	1989	1988	Δ '89-'88	1989	1988	Δ '89-'88	1989	1988	Δ '89-'88	1989	1988	Δ '89-'88	1989	1988	Δ '89-'88
12/01	121.5	128.9	-7.4	52.0	56.2	-4.2	6.5	7.4	-0.9	29.1	32.6	-3.5	16.3	16.2	+0.1
12/08	118.5	126.5	-8.0	49.6	54.5	-4.9	5.7	7.3	-1.6	27.7	31.0	-3.3	16.1	16.2	-0.1
12/15	116.2	126.0	-9.8	43.4	54.3	-10.9	4.8	7.1	-3.3	24.7	31.0	-6.3	15.8	16.1	-0.3
12/22	112.2	125.4	-13.2	40.5	52.5	-12.0	3.9	6.2	-3.3	21.4	30.2	-8.8	15.2	16.1	-0.9
12/29	108.2	126.8	-18.6	37.9	52.5	-14.6	3.0	6.1	-3.1	20.6	29.6	-9.0	14.3	16.8	-2.5
EFF 12/29															
Est. Days' Supply															
- Based on Dec. '88 First Sales Volumes	29.8			21.8			7.1			23.0			34.1		
- Based on Dec. '88 +13%	26.4			19.3			6.3			18.7			30.2		

(1) Source: American Petroleum Institute, Weekly Statistical Bulletin.

inventory movements to relieve the tightness in the Northeast had not yet occurred.

- In addition to the strained primary stock levels, Platt's Oilgram Price Report's survey of Northeast secondary DFO storage capacity indicated utilization of just 32% effective December 8, 1989 (vs. 56% a year earlier), falling to 29% effective December 15, vs. just 12% effective December 16, 1988. This suggests that secondary inventory levels were relatively low early in December, but were not drawn down extraordinarily through the first half of the month.

- The National Petroleum Council estimated total national secondary storage capacity (bulk station < 50,000 barrels) for DFO to be just 29 MMB in 1988 (down from 37 MMB in 1983), with tertiary (end-user) DFO capacity at 255 MMB, versus 282 MMB in 1983. This downstream storage capacity concentration at the end-user level suggests that the potential to manage DFO inventory levels as a defensive strategy may fall largely with end-users, with some cooperation in entering contractual or price guarantees provided by refiners and distributors.

- Other fundamental factors which pressured DFO prices included the following:

Imports

- Strong Western European demand in late November and early December, coupled with reduced gasoil exports from both Russia (a carry-over from the summer coal strike) and Romania, reduced normal European supplies, causing a larger-than-normal share of Caribbean, Mediterranean, Mid-East and other export sources to be diverted to Western Europe rather than U.S., where prices had not yet soared. (See Attachment 2.)

- By the second half of December, a price advantage to move DFO supplies to the U.S. had clearly developed, but time lags, limited U.S. flag vessel availability, and delays in obtaining exemptions may have limited an otherwise rising level of late-December imports.

Inter-District Flow (Colonial Pipeline Freeze and Proration)

- Due to weather-driven demand, and an unusually high last minute rush by shippers to secure pipeline space, Colonial Pipeline was forced to freeze its 36th Cycle DFO nominations effective December 23rd. Normally, when nominations are made with greater lead time and lower volume, peak period demand can be prorated in an orderly manner. Once into a cycle (the 36th Cycle starting December 21), Colonial does not prorate because supply commitments have already been made. This freeze on existing nominations exacerbated the supply-side panic immediately prior to a freezing 3-day Christmas weekend. Ensuing refinery shutdowns and other infrastructural problems helped push spot prices up another 20¢/gallon over the next week. Colonial also prorated its 1st Cycle 1990 shipments effective January 1, 1990, but relaxed this proration two days later to allow reasonable increases as line space become available (in part due to lower Gulf Coast refinery output).

- A number of weather-related temporary shutdowns of various major refinery units on the Gulf Coast (see Attachment 1) reduced overall refinery runs by nearly 10% (1.5 MMB/D), and DFO output by an estimated 300-400 MB/D over the least week of December.

- By late December East Coast barge availabilities were reported to be very limited, pushing their prices and delivered costs up.

- In mid-December low water levels on the Mississippi river forced a reduction in barge traffic, reducing mid-Continent supplies and pressing pipeline deliverability and prices.

- Around December 20 a leak at Exxon's Arthur Kill facility limited barge traffic in New York Harbor for several days.

International Market

- Low Eastern European gasoil exports, strong Western European demand
- Relatively low stock and strong product and crude demand into Japan, Far East
- Venezuelan No. 2 fuel cargo explosion, Brazilian oil workers strike
- Panama invasion, fear of pipeline and canal closing around December 20
- Temporary shutdown of Suez Canal due to grounded tanker around December 20
- North Sea platform producing 30 MB/D shutdown due to leaks also around December 20

This myriad of weather and unrelated stresses on the physical delivery system, both domestically and internationally, added to the tension created by the severe cold weather and tight inventory situation.

Futures Market

The futures market has often been cited as a contributing factor to price volatility from both a commercial and speculative use perspective (see next section's discussion). From a commercial perspective the questions have been raised as to whether futures markets exacerbate the spot price movements, and secondarily, as to whether futures markets encourage low inventory holdings. While I believe that futures markets can add to the appearance of short-term price volatility, the price path evidence shown in Attachment 4 clearly indicates that this past December's surge was largely led by the cash, or prompt, market.

Concerning inventory holding incentives, futures markets do indeed provide a capability to in essence store inventory "on the board" rather than in tanks. However, this incentive should be viewed in the context of the industry's broader competitive pressures to lower operating costs. Furthermore, any incremental reduction in inventory is likely to occur at the secondary and tertiary levels because these inventories are typically controlled by net buyers of petroleum products, not refiners. Table 3, below, shows a comparative profile of open interest volume in the heating oil futures contract for this year vs. last year. The January contract's open interest and total market open interest are shown for the November-December period. The table reveals that this year's January 1990 open interest was indeed greater than the year-earlier level on an absolute basis over the entire period. However, as a percentage of total market open interest, the January 1990 contract was actually below last year's level. Furthermore, for every long position willing to stand for delivery there is a short willing to deliver. This year, the unwillingness of longs to liquidate their positions prior to maturity largely reflects the strong prompt (spot) market price premium in effect. Similarly, the relatively sharp decline in open interest this year over the past week, coinciding with a rapidly rising futures (and cash) price, suggests that many shorts were either forced out of their positions by rising prices, or opted to sell their inventories at the relatively strong late December cash price, rather than waiting till early January.

Table 3

Comparison of NYMEX Heating Oil Open Interest Trends:
November-December 1989 vs. 1988
(Number of 1000 BBL. Contracts)

	November-December 1989			November-December 1988	
Date (previous day's open interest)	Jan. '90 Contract Only	Total Hoil Market	vs.	Jan. '89 Contract Only	Total Hoil Market
Nov. 1	25,001	91,209		24,278	96,150
Dec. 1	44,184	102,093		32,196	82,868
Dec. 15	26,417	105,836		20,715	81,784
Dec. 22	17,244	107,038		12,550	77,404
Dec. 29 '89 vs. (Dec. 30, '88)	7,270	102,451		5,270	77,312

II. A Broader Perspective of the Price and Margin Formation Process

These recent events should be viewed in the broader context of the industry's evolution to a competitive international market structure characterized by a shift in profitability from capacity-constrained crude oil production in the late 1970s to capacity-constrained refining in the late 1980s. Because refiners now exact little control over crude oil prices and production levels, and incremental supplies (of both crude and product) are increasingly obtained from foreign sources, the stabilizing link between crude oil production and refined product sales has been largely uncoupled. This places refiners in a riskier position of planning for future demand, and hence refinery process capacity expansion, in a highly uncertain price and margin environment. Moreover, stricter environmental standards are increasingly dictating the necessary investment in refinery upgrades and expansion, adding to cost without guaranteeing an adequate long-run return on investment.

Over the next three-five years, new refinery or downstream process investments are likely to be made in an incremental or minimalist fashion relative to expected product demand growth. Therefore, we can expect at least several more years of high domestic refinery utilization rates, characterized by continued strain on the process units, frequent unanticipated mechanical problems and relatively volatile margins and price relationships as external market factors or internal supply problems strain the short-term supply-demand balance.

A look at the last two years reveals the increasingly volatile nature of the oil price formation process, particularly when viewed in terms of the spread between crude oil and product prices (gross refinery margins) and between refined products (intra-barrel refinery economics). Attachment 4 shows the recent two-year history of futures "crack" spreads, or the immediate margin between the nearby product and crude futures prices. From a relatively stable pattern in 1987 and 1988, 2nd and now 4th quarter 1989 price and margin trends have been quite volatile. Indeed, the recent $8/barrel weekly average peak in heating oil's gross margins over WTI crude is comparable to the April 1989 peak in unleaded motor gasoline margins. However, on an average basis a 2:1 weighting of gasoline to heating oil suggests that, even recently, overall gross refining margins are not inordinantly high given the underlying circumstances. In December 1989, heating oil's relatively high $7-$8 gross margin compares to a gasoline level below $2, for a weighted average of around $4/barrel. During April and May of 1989 the gasoline price crisis, similarly, produced gross margins of $4-$5/barrel, with the higher production cost of motor gasoline reducing total net refining margins by at least $2-$3/barrel.

In some respects the heating oil price spike of late 1989 can be viewed as the flip side of 2nd quarter 1989's extremely low heating oil margin path. High distillate output associated with intense crude distillation and downstream process utilization to make gasoline increased DFO supplies beyond market needs. The incremental shutdown of refineries for maintenance turnarounds, traditionally beginning in September, was deferred until October and November due to the strains on process unit utilization induced by the gasoline market (specifically the lower RVP and higher octane content) this past spring and summer. As a result, new DFO supply levels and inventories were lower than they otherwise would have been during 4th quarter 1989.

In 1990 the relatively tight DFO inventory situation poses a similar risk for motor gasoline markets. Specifically, overall utilization rates will have to be raised to catch up with December's shortfall. Output emphasis will have to be on DFO in the near term, deferring the traditional 1st quarter motor gasoline stock build until distillate supply-demand balance have returned to more normal levels. With even stricter gasoline RVP requirements this year, and continued demand growth, the potential for another gasoline-led price spike again looms on the horizon.

The two product-led price spikes during the past year are a reflection of a new, more sensitive price formation process. Three major commercial trends account for this increased sensitivity in oil prices and margins:

(1) Since early 1988, most international commerce in crude oil has been priced in direct linkage to major transparent spot and futures market prices, utilizing such spot or. futures crudes as Brent, Dubai, Alaskan North Slope and West Texas Intermediate.

(2) Beginning in the second half of 1988, U.S. and other major consuming and refining regions started to experience light product demand levels which strained their existing refinery process capacity. This strain on available refinery capacity was intensified by environmental or quality pressures (lower lead, higher RVP, lower sulfur, higher octane). As a result, price pressures are now often manifested first in sharp increases in the prompt or nearby price of light petroleum products, leading the crude oil price up in some lagged fashion due to the "bellows effect" of the intra-barrel economics previously discussed. The cushion of spare refinery capacity has been eroded, and with it the buffer to product-led price movements has been removed.

(3) Price formation in the product markets, like crude oil, is now increasingly an open market or "transparent" process, with major futures, forward or spot prices serving as references or standard-bearers

for the vast majority of product sales in the U.S. and in international trade.

Taken together, these three developments have created a market which reacts quite sensitively to fundamental developments. As long as the fundamental pressures are viewed as temporary, the price adjustment process, while pronounced in the short run, corrects more rapidly than it would in a more rigid pricing environment. The existence of futures and option markets, open to non-commercial speculators, has speeded this evolution to a competitive, albeit unstable, pricing standard. In volatile periods the role of futures markets, and in particular speculative activity, is a source of continuing controversy, regardless of the commodity. In the heating oil contract, a recent NYMEX evaluation of positions indicated that approximately 25% of major firms' open interest in heating oil is typically accounted for by speculators. On a comparative basis this is not an unusually high number. However, in the context of market upheaval, speculators who are "caught short" can indeed add to the snowball effect of upward price momentum by having to buy back these positions as their futures losses mount.

By contrast, a true commercial short hedger reaps the gain of rising inventory value to offset his short futures losses. The stabilizing vs. destabilizing role of futures markets, and particularly speculative participation, has been debated for years in academic, government and industry circles. It is my opinion that in a real supply crisis the prompt cash price will lead the futures price. However, I also believe that speculators do probably add somewhat to the market's short-term volatility, but over time they play an important stabilizing role due to their willingness to take on industry price risk.

The pronounced adjustment process is concentrated largely in the prompt or spot market, rather than in forward months. Attachment 2 demonstrates this point in showing a clear linkage between upward price pressure and the degree of the spot-2nd month price spread premium in the NYMEX crude futures market. Similarly, during the recent December price rise, the nearby (Jan.) and 2nd month (Feb.) heating oil contract prices were led by the prompt spot market price for immediate delivery (i.e., the New York Harbor spot barge price plotted in Attachment 3). Note that the prompt spot price increased its premium over the January futures price as absolute price strength accelerated in the second half of December. However, on the last trading day for the January futures contract these prices converged since the January futures became a cash market (deliverable) price on the next business day.

In an escalating price environment, retailers and wholesalers, particularly those short on inventory, usually suffer a margin squeeze as prices and costs rise more rapidly than their ability to pass through these higher costs to customers. However, these marketers will seek to recoup this profit erosion as prices fall, passing through their cost reduction less rapidly, particularly in periods of strong winter time demand.

Attachment 5 shows a comparison of Central Atlantic area resellers' apparent average wholesale and retail margins over the past 21 months. Graph A plots the difference between these companies' average sales prices to residential consumers and their resale price average, or a surrogate gross retail margin. Note that retail margins tend to weaken in late summer, and also with a sharp wholesale price increase (e.g., as in Sep. '89, Nov. '88). The catch-up period for gross retail margins tends to take 1-3 months, with a seasonal peak in the 1st quarter.

Reports of residential and commercial consumers paying $1.50/gallon + for heating oil in late December and early January may or may not suggest gouging on the part of resellers and distributors. A retailer caught short on inventory, and forced to pay a premium for spot supply, may well have paid $1.10+ gallon around this time. Adding a typical gross margin of 30-40¢/gallon (see Attachment 5) gives the $1.50 price.

The critical variable in determining whether a marketer may be profiteering at the customer's expense is the length of time (i.e., volume sold) at a particular price, relative to that supplier's purchased cost of inventory. A quick retail price increase should be matched by a relatively quick decrease as No. 2 fuel wholesale prices decline. Variables such as the volume-weighted cost of inventory for a specific supplier (*vis-a-vis* the market average), incremental operating costs to meet peak demand, physical accessibility and the number of supply alternatives in a particular area will affect the assessment of what constitutes a competitive price.

At the moment, price and margin data on retail vs. wholesale differentials are not yet available on which to base a competitive assessment. I would encourage consumers to maintain records of dated invoices and volumes so that these can be compared with a given market area's estimated wholesale fuel cost to marketers. Apparent differentials which exceed seasonal norms, after taking into account the supplier's higher operating cost and year-round margin performance, may warrant further attention and a local competitive response by these consumers. State and local governments may want to take a lead in initiating such activity, but the focus should be on longer-term solutions, not short-term punitive actions.

In general, it is my opinion that most areas along the East Coast are characterized by a sufficient degree of supply and price competition to insure adequate supplies and reasonable prices over time. Unusual circumstances, and the increasing strain on the refinery and import delivery system suggest that marketers could be caught in these volatile cost-price environments again. Volatile periods raise the risk-reward profile for these marketers, just as they do for any link in petroleum distribution chain. Opportunities to make money by selling at what the market will bear increase, just as does the exposure to an unavoidable cost vs. price squeeze. My final comments focus on how consumers, including state and local governments, might reduce their exposure to future supply-price stresses, largely through free-market strategies, and possibly with some targeted state and local assistance. In general, effective inventory management becomes crucial in this environment. It is precisely the free market competition which evolved over the past decade that has caused a tighter downstream inventory situation. When competition is intense around 1-2¢ price differentials, the incremental inventory carrying cost has forced a low discretionary inventory policy to meet the competition. From the suppler perspective, higher risk justifies a higher reward.

III. Potential Solutions From a Consumer Perspective

Given the increased risk associated with upward oil price exposure, and a likely 3-5 years+ lag in major U.S. and worldwide refining capacity expansion, I would highly recommend that end-users/consumer groups begin to take advantage of some of the oil price insurance vehicles available in today's market. A short list and description of potential strategies is provided below:

(1) Request that your supplier offer a fixed winter (or year-round) price of heating oil based on a fixed differential from prevailing futures market prices.

Most wholesalers and some distributors are by now aware of how their purchase costs relate to the NYMEX heating oil price. Many are already offering consumers this sort of price protection. Consumers, on the other hand, must recognize that by locking into a fixed price, they do not participate in any downside price movement which might develop. In essence, consumers can contract for price fixity over the next month, year, or even five years.

(2) Rather than fixing prices at current levels, consumers could ask their suppliers to offer them a

ceiling price (above the current market level) at which the marketer's delivered price would be capped.

The buyer pays an option or insurance premium to the supplier under the arrangement, with its unit price a function of the level of the price ceiling selected and the terms of the arrangement.

(3) Pursue a variant of futures and options hedging approaches utilizing a commercial bank or trading house "over-the-counter" price insurance.

Direct participation in these markets by residential consumers may be difficult unless an effective, financially solvent, and comparatively large buying entity can be established. These could include consumer cooperatives, with or without state or local government participation. Direct state or local government participation is often limited by statute, policy, or other organizational constraints. An intermediate step to direct participation may be to approach an "over-the-counter" swap or option market maker. A number of such offerors have emerged over the past year, largely Wall Street banks, investment houses and trading companies. Their ability to offer price protection extends beyond the

6-12 month horizon normally traded on the futures exchange. Indeed, futures or options-based price protection in heating oil can be obtained for up to 10 years. Where budget fixity or uneven fuel cost patterns are a major concern, a variety of fixed or capped and floored long-term arrangements can be structured. Again, because credit risk and financial solvency are a concern, an effective organization with financial backing is needed to secure such an arrangement. On the other hand, because these off-exchange instruments do not necessitate direct participation in the futures or option markets, they should prove more attractive to end-users, including state and local governments, who otherwise are not equipped to participate directly. State and local use of such a strategy to back a specific government program, such as an oil assistance program may be a useful first step into this sort of price insurance activity.

While hindsight is 20/20, I note that in August and September of this year, average winter '89-'90 heating oil prices of 55-57¢/gallon could have been secured. On the over-the-counter market, a five year winter average of just 1-2¢/gallon above this figure was obtainable. If price insurance is desired, there are now a number of contractual alternatives to achieving it. The key requirements are education, organization and financial backing.

Another approach to achieving price and supply security involves purchasing lease or storage "reservation rights" with fuel suppliers. As previously noted, the existence of futures markets and intense margin competition has reduced the volume of petroleum products normally carried in inventory. As a result, more storage capacity is available at all levels (primary-secondary-tertiary) of the distribution chain. Consumers can create financial incentives to utilize a higher percentage of this capacity by paying some sort of reservation fee to suppliers.

(4) The simplest approach to storage reservation would simply be for the buyer to pay his supplier a negotiated cost of carrying inventory. This fee could average as much as 1.0-1.5¢/gallon per month and, therefore, would have to be weighed carefully against the financial alternatives discussed above.

(5) A more sophisticated approach would consist of reserving a call on a certain volume of inventory per

month, without requiring a dedicated reserve. Under this arrangement the storer would be free to turn over his overall inventory in an efficient manner, with only the constraint of meeting the storage customers monthly minimum from the total pool. This approach would likely reduce unit storage costs, but would not necessarily add significantly to the overall inventory pool.

(6) An alternative approach, requiring government participation at the state or federal levels, would be to enter a leasing arrangement which ensures greater quantities through an incentive fee to promote a higher 'than normal' level of inventories. In an emergency, these inventories would immediately become available to the lessee. Importantly, the reservation fee would also carry a stipulation that the storer not replace the leased inventory while the disruption prices were in effect, or for some pre-specified time period, subject to verification. This approach would incrementally discourage product hoarding and ensure a more rapid movement of product stocks to end-users. Moreover, as a government-backed activity (whether at the state or federal level), public perception would be positive and tertiary hoarding would presumably also be restrained. In essence, this approach is

similar to a regionalized, product-specific leasing arrangement for immediate petroleum product in a disruption; analogous to the proposed SPR crude oil leasing arrangements currently under consideration. An EFG memo on this subject is submitted as Attachment 6 to this testimony.

In summary, a variety of approaches to securing prices and incremental supplies are available in today's market place. Ultimately consumers will have to bear these costs in the form of insurance premiums. In our view a concerted effort at the grass roots consumer/end-user level, coupled with similar action and targeted financial support by state and local governments, offer the best intermediate solution to the product led upward price volatility experienced in 1989, and to which we will remain vulnerable for the foreseeable future.

On the broader scale, incentives for refinery constructions and expansion may merit further investigation. Similarly, the role of the Federal Government, whether through a modified Strategic Petroleum Reserve on through a policy of state and local matching funds might also be considered.

Attachments

1) Reported Refinery Problems

2) NYMEX Heating Oil Futures Nearby and Second Month Prices vs. IPE Nearby Gasoil (IPE-International Petroleum Exchange)

3) New York Harbor Spot Barge Prices vs. NYMEX Heating Oil Futures Nearby Contract

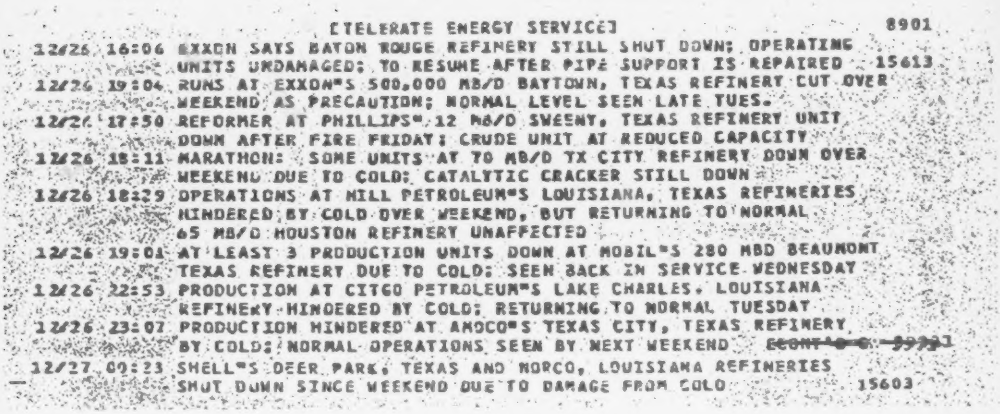
4) Heating Oil and Unleaded 1/1 Nearby Crack Spread, Weekly 1988-89

5) Average Reseller Residential vs. Resale No. 2 Fuel Prices in PAD 1B, 1988-89, vs. Average Futures Prices

6) EFG May 1989 Memo to DOE, Office of Petroleum Reserves, May 1989, on A STRATEGIC LEASED RESERVE FOR GASOLINE

Attachment 1

Reported Refinery Problems



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                    [TELERATE ENERGY SERVICE]                            8901
12/26 16:06 EXXON SAYS BATON ROUGE REFINERY STILL SHUT DOWN; OPERATING
            UNITS UNDAMAGED; TO RESUME AFTER PIPE SUPPORT IS REPAIRED   15613
12/26 19:04 RUNS AT EXXON"S 500,000 MB/D BAYTOWN, TEXAS REFINERY CUT OVER
            WEEKEND AS PRECAUTION; NORMAL LEVEL SEEN LATE TUES.
12/26 17:50 REFORMER AT PHILLIPS" 12 MB/D SWEENY, TEXAS REFINERY UNIT
            DOWN AFTER FIRE FRIDAY; CRUDE UNIT AT REDUCED CAPACITY
12/26 18:11 MARATHON:  SOME UNITS AT 70 MB/D TX CITY REFINERY DOWN OVER
            WEEKEND DUE TO COLD; CATALYTIC CRACKER STILL DOWN
12/26 18:29 OPERATIONS AT HILL PETROLEUM"S LOUISIANA, TEXAS REFINERIES
            HINDERED BY COLD OVER WEEKEND, BUT RETURNING TO NORMAL
            65 MB/D HOUSTON REFINERY UNAFFECTED
12/26 19:01 AT LEAST 3 PRODUCTION UNITS DOWN AT MOBIL"S 280 MBD BEAUMONT
            TEXAS REFINERY DUE TO COLD; SEEN BACK IN SERVICE WEDNESDAY
12/26 22:53 PRODUCTION AT CITGO PETROLEUM"S LAKE CHARLES, LOUISIANA
            REFINERY HINDERED BY COLD; RETURNING TO NORMAL TUESDAY
12/26 23:07 PRODUCTION HINDERED AT AMOCO"S TEXAS CITY, TEXAS REFINERY
            BY COLD; NORMAL OPERATIONS SEEN BY NEXT WEEKEND   [illegible]
12/27 00:23 SHELL"S DEER PARK, TEXAS AND NORCO, LOUISIANA REFINERIES
            SHUT DOWN SINCE WEEKEND DUE TO DAMAGE FROM COLD             15603
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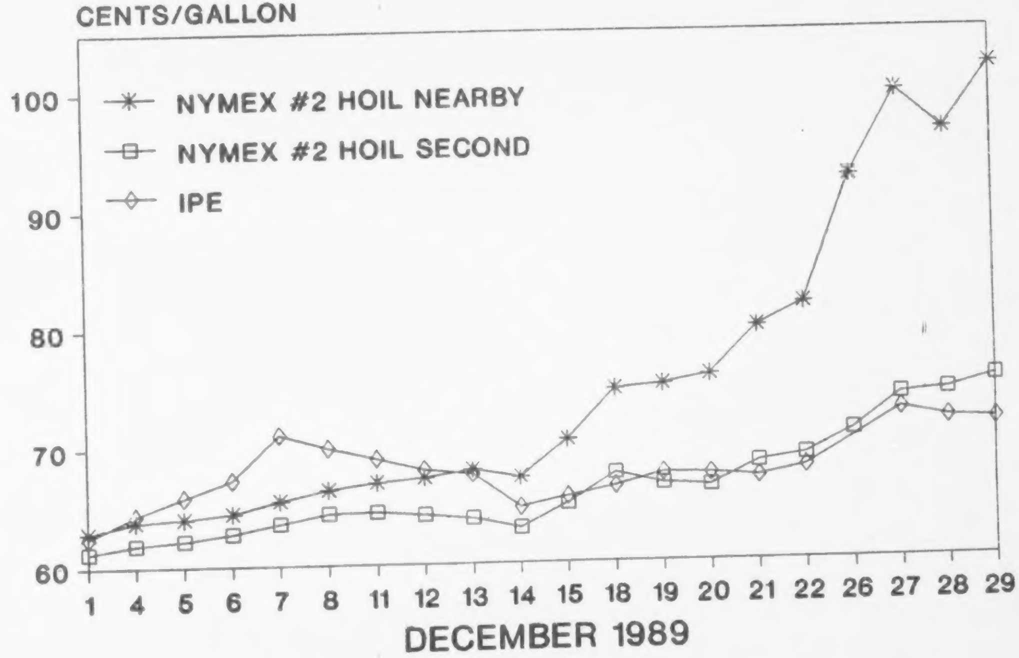
Other Refinery Unit Shutdowns Reported, Not Shown Above Include:

Date	Reported Shutdown
	(Oil Daily)
Dec. 25	Texaco/Star reports some units down for 4-5 days in their 250 MB/D Port Arthur, Texas refinery
Dec. 18	Chevron's El Segundo, California 300+ MB/D refinery reports a fire in one process unit
	(Platt's Oilgram Price Report)
Dec. 26	Weather-induced problems reported affecting Coastal Corp's Corpus Christi, Texas refinery (90 MB/D) and Koch's Texas City, Texas refinery (125 MB/D)

Attachment 2

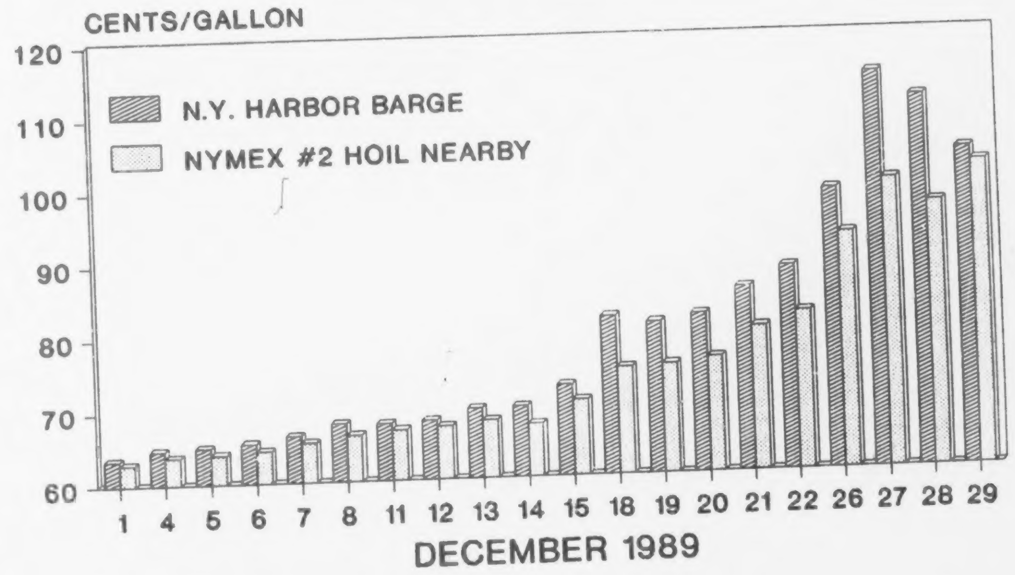
NYMEX Heating Oil Futures Nearby and Second Month Prices vs IPE Nearby Gasoil



The ENERGY FUTURES GROUP, Inc.

Attachment 3

New York Harbor Spot Barge Prices vs. NYMEX Heating Oil Futures Nearby Contract

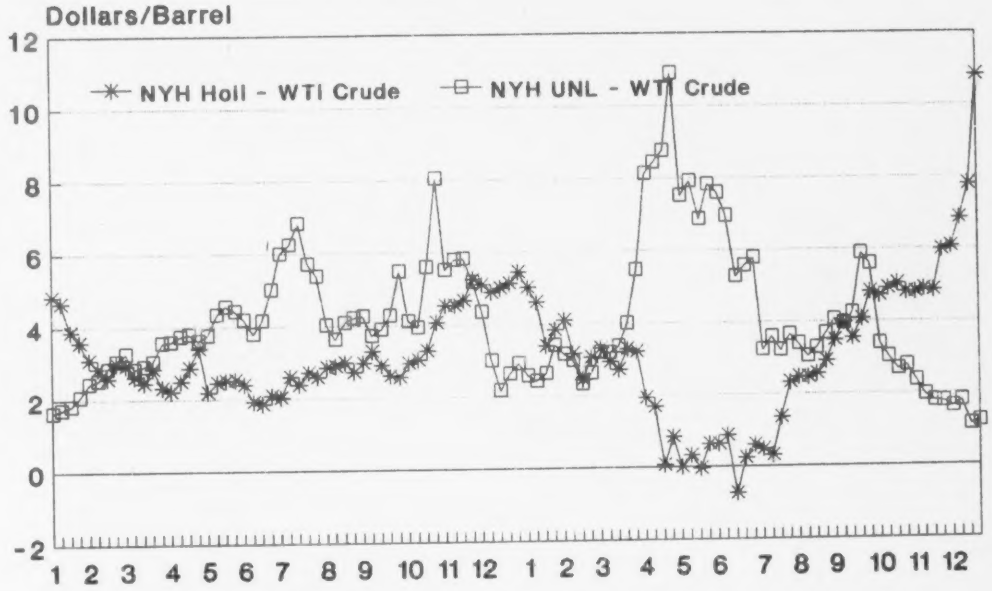


The ENERGY FUTURES GROUP, Inc.

Source: Platt's Oilgram Price Report and Oil Daily

Attachment 4

Heating Oil and Unleaded 1/1 Nearby Crack Spread*
Weekly 1988-89

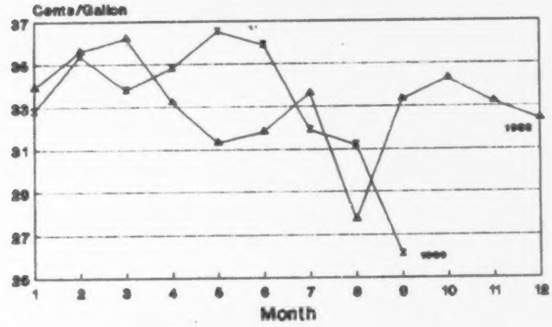


The ENERGY FUTURES GROUP, Inc.
*Crack Spread=(UNL or HOIL)*42-Crude Oil

Attachment 5

PAD IB Residential Price Minus
Resale Price
Monthly Averages 1988-1989

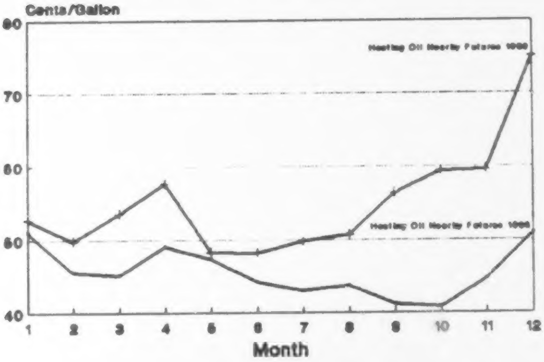
(A)



Source: Petroleum Marketing Monthly, DOE

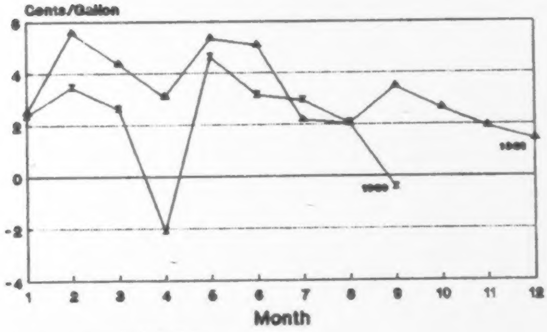
NYMEX Nearby Heating Oil Futures Price
Monthly Averages for 1988-1989

(B)



PAD IB Resale Price for Retailers Minus
NYMEX Nearby Heating Oil Futures:
Monthly Averages 1988-1989

(C)



The ENERGY FUTURES GROUP, Inc.
Source: Petroleum Marketing Monthly, DOE

Attachment 6

EFG Memo to DOE, Office of Petroleum Reserves

May 1989

A STRATEGIC LEASED RESERVE FOR GASOLINE

INTRODUCTION

The impact of an oil supply disruption on gasoline consumers is likely to be one of immediate hoarding by maintaining a higher average level of gasoline in the motorist fuel tank. If the average driver maintains an average of 1/3 of a tank of gas during during normal times, the threat of disruption could cause him to increase that level to 2/3 of a tank. If an average gas tank holds 15 gallons of gasoline, then increasing the average level to 2/3, means an increase of 5 gallons per automobile. With 125 million cars on the road, this represents an inventory increase of 625 million gallons in a very rapid period of time, perhaps 1-2 weeks. It represents about 15 million barrels, or around 2 days supply.

This inventory would be shifted from so-called secondary stocks, where gasoline is stored in terminals close to the market, to tertiary stocks; i.e., to the consumer's gas tank. This shift would, in turn, be passed through to primary inventories at refineries, which would then require an increase in crude stocks, and therefore in crude purchases in the face of the perceived supply disruption.

Media focus on the issue, both as to the nature of the supply disruption (real or expected) and its potential impact on gasoline supplies, would almost certainly heighten the anxiety of the average motorist. Confusing statements by government officials, highlighted by the media, would add to the sense of uncertainty. And all of this could happen very rapidly, with reported prices rising sharply as the government and oil companies tried to analyze the potential severity of the disruption. At that critical time, action not analysis, may be called for. On the other hand, it may be too early to call for a general drawdown of the Strategic Reserve, and a Presidential declaration of an energy emergency could well exacerbate the potential panic.

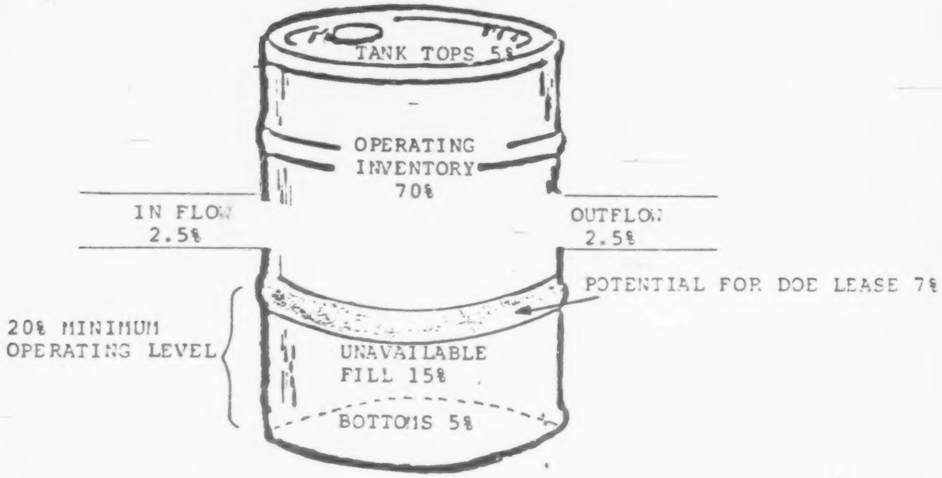
It is in this regard, that a small regionally based, reserve of gasoline stocks might be employed. As the TV cameras focused on the gasoline consumer at the service station, the DOE sponsored tank truck would arrive. Such is the nature of media determined psychology, both on the part of the consumer and the oil supplier, that a rapid government reaction could counter with a modest addition to gasoline supplies. This action would, moreover, allow more time for DOE and the White House to make a decision concerning a Presidential declaration.

COSTS

What would it cost to set aside for emergency purposes an additional 15 MMB of gasoline? The product could be leased from the terminal operators; and, although it would continuously turnover, it would be available in an emergency. These leased stocks would represent additional profits for the terminal operators, provided the program were structured in an appropriate manner.

In fact, no additional gasoline stocks would be needed, and DOE could lease certain existing inventories already in the terminals. To understand this concept, consider the following illustrative exhibit of a gasoline storage tank.

GASOLINE STORAGE TANK ILLUSTRATION



In normal times, the terminal operator will only utilize about 80% of his storage capacity. His minimum operating level of 20% includes 5% tank bottoms, plus about 15% fill level, below which he will not drain his tank for fear of stock-out and for tank fill operational purposes. Although all the gasoline (except the bottoms) constantly turns over because it would otherwise evaporate, the practice in the industry is to never let a storage tank go below 20% of its capacity. In other words, the terminal operator still pays for this unutilized 20% which is in reality unavailable, but its cost must be covered by the remaining 80%.

Thus, when reported statistics show a 30 days supply of gasoline inventories, it is in reality only a 24 days supply, since only 80% of the inventory is available. DOE's goal would be to increase this 24 days of available supply to 26 days by paying the terminal operator an incentive fee to utilize around 7% more of his inventory in a disruption than he would during normal times. Thus, by drawing down around 7% below the commercial minimum operating level during a disruption, an additional 2 days supply could become available almost immediately.*

The incentive fee for the terminal operator would be in the form of a lease payment by DOE. The annual leasing cost might range from 2%-6% of the value of the oil, since the terminal operator is really doing nothing new, except for making a commitment to supply additional gasoline at the instruction of the government. In return for this commitment, he would be getting added revenues with no additional costs. As a result, 15 MMB of leased gasoline with a wholesale value of around $21/barrel ($.50/gallon) would cost DOE betwen $6.3 million and $18.9 million annually.

The contract between DOE and the terminal operator would require the terminal operator to sell these additional barrels upon instruction by DOE. The terminal operator might be given 5-10 business days to accomplish this after receipt of instructions from DOE. He could sell these additional barrels through his normal channels to service stations or into the spot market. He would naturally keep the additional revenues, but would not be allowed to refill his tanks for a prespecified period beyond the sale, say 15-30 business days. Not only would the terminal operator be agreeing to make available additional gasoline which would otherwise be held off the market, but he would also be agreeing not to increase his precautionary demand for gasoline stocks in the face of a potential supply disruption. Thus, instead of increasing his minimum operating level to 25-30% during a disruption, he would be decreasing that level to 13%.

A formal contract between DOE and the terminal operator would specify that in return for the annual incentive fee (i.e., lease payment), the terminal operator would agree to follow DOE's instructions, should DOE issue them. The contract might run for 10 years, after which it could be renewed or dropped by either party. If the terminal operator did not receive any DOE instructions, i.e., if no disruption occurred, then the terminal operator

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* As a formula, the additional percent of inventory below commercial minimum is determined by:

$$\frac{\text{Target}}{\text{Reported}}\text{ DS} - \frac{\text{Actual}}{\text{Reported}}\text{ DS} = \frac{26}{30} - \frac{24}{30} = .067$$

would go about his business as usual. Finally, DOE might require a participating terminal operator to post a performance bond over the life of the contract. The cost of this performance bond might be in the 1%-2% range, in which case, DOE would end up paying for it in somewhat higher lease costs.

ADMINISTRATION

Such a program would require a certain added burden of compliance costs. With a performance bond in effect, DOE would have to certify to the bank whose funds are at risk that the terminal operator fulfilled his obligations. This would mean a certain amount of after-the-fact auditing by DOE of participating terminal operators. There is some risk that certain terminal operators might cheat by "fudging the figures". In most cases, however, where the terminal operator was part of a sizeable oil company, the gains from cheating could be far offset by the penalties and negative publicity of getting caught. Although the program would not be mandatory, it is nevertheless a private sector reserve, and some additional compliance related costs are likely.

REGIONAL RESERVES

A strategic reserve for gasoline, situated close to the consuming public, would necessarily have to be a regional reserves program. That is, DOE would have to select key consuming centers, served by the associated tank terminals. This could cause political problems as DOE selectively eliminated smaller population centers and rural areas. To avoid these kinds of problems, the budget for the program could be allocated to the states on the basis of population (people or motor vehicles) and let the state governments decide where to place the strategic gasoline reserves. DOE could coordinate the program, and still remain the government party to the agreement with the private sector terminal operator. Pushing the selection process down to a more localized level, however, might reduce some of the inter-regional political problems likely to arise in the Congress. In addition, State Energy Offices possess more of the relevant information concerning city and county gasoline consumption and the location of gasoline tank terminals serving these markets.

On a national basis, average monthly gasoline consumption is about 10 billion gallons (or 225 MMB), with 17 states accounting for 70% of that figure. The major metropolitan areas in these states account for 50%-90% of the statewide figures. On a national basis, therefore, the targeted gasoline consumption would be 3.5-6.3 billion gallons per month. Two days supply would be in the 6-10 MMB range. Using an average of 8 MMB, 53% of the entire national figure of 15 MMB, annual leasing costs could be reduced to a range of $3.3-10.0 MM.

GASOLINE CONSUMPTION IN MAJOR STATES
(billions of gallons, monthly)

California	1.1
DC Area (incl. MD. & VA.)	.5
Florida	.6
Georgia	.3
Illinois	.4
Indiana	.2
Massachusetts	.2
Michigan	.4
Missouri	.3
New Jersey	.2
New York	.5
North Carolina	.3
Ohio	.4
Pennsylvania	.4
Tennessee	.2
Texas	.8
Washington	.2
Total	7.0
Total National	10.0

EXAMPLE I: SOUTHERN CALIFORNIA

The California Department of Transportation tracks statewide gasoline consumption through state tax records. No statistics are kept by city or county. However, based on population and motor vehicle registration data, estimates of gasoline consumption are available by county. The table below shows the relevant data for 1987.

Estimated Southern California
Gasoline Consumption - 1987
(millions of gallons)

Total State	12,600	
Total SCAG*	48.5%	
San Diego	8.1%	
Total Southern California	7,100	
Average Monthly Consumption	592	
Peak Monthly	710	
Days Supply	24	
2 Days Supply	48	(= 1,143,000 bbls.)

* Southern California Area Governments representing a 6 county area around greater Los Angeles.

For Southern California, therefore, DOE would have to lease 1,143,000 barrels of gasoline in order to increase the effective days supply by 2 days. At \$21/barrel (\$.50/gallon), the annual cost would range from \$480,000 (at 2%) to \$1,440,000 (at 6%). If the minimum size terminal to qualify for the program were set at 50,000 barrels, then DOE would distribute these funds among at most 23 terminals, for an average lease cost of \$21,000-\$63,000 per year per terminal.*

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* There are an estimated 334 secondary storage facilities in Southern California, ranging in size from 2000-150,000 barrels of gasoline storage capacity. There are also additional primary storage facilities.

EXAMPLE II - NEW YORK CITY, NASSAU, SUFFOLK, & WESTCHESTER COUNTIES

The New York State Energy Office estimated 1987 statewide gasoline consumption at 6.164 billion gallons. The City plus the three New York counties accounted for an estimated 47.8% of that consumption, or 2.95 billion gallons. This represents 246 MM gallons per month, and about 300 MM gallons in the peak months. Two days supply in the peak months would, therefore, be 20 MM gallons, or 476,000 barrels.

If DOE were to lease this quantity, the annual cost would range from $200,000-$600,000 (at $21/barrel for a 2%-6% lease cost). If the minimum size terminal for the New York program were 20,000 barrels, DOE would distribute these funds among at most 24 terminals, for an average lease cost of $8300-$25,000 per year, per terminal.*

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* There are an estimated 180 secondary storage facilities in the New York City area, ranging in size from 2000-75,000 barrels of gasoline storage capacity.

CONCLUSIONS

The cost/benefit trade-off for a regional gasoline reserve is presented below. We have estimated a minimum size program costing \$3.3 MM annually and a maximum size program of \$18.9 MM annually, depending on lease costs and the scope of the program.

Annual Program Costs (\$MM)

Scope

Lease Costs	National	Key Metro Areas
2%	6.3	3.3
6%	18.9	10.0

The average of the above figures is \$9.6 MM, which when compounded at 9% over 10 years is \$159 MM (i.e., assuming deficit financing). If the additional 2 days supply of gasoline could restrain gasoline prices from rising rapidly over 2 weeks, the benefits could be quite large. Two weeks consumption is about 105 MMB, so that the cost of the program can be estimated \$1.52/barrel, or \$.036/gallon. It is almost certain that without such a program, or without early release of the SPR, gasoline prices would rise by susbtantially more than \$.036/gallon in the first two weeks of a disruption.

The negatives of the program would be two-fold. First, inter-regional disputes are likely at the Congressional level, and urban-rural disputes at the State levels. Second, compliance or audit costs could be burdensome, should the program have to be implemented in a real disruption. There are, in addition, the usual administrative, bureaucratic, and implementation pitfalls which any new federal program is likely to encounter.

If internal DOE reaction to the proposal is positive, we suggest that a survey of oil companies, state officials, and key Congressional staffers be done prior to any formal proposal to Congress or the President.

Statement

of

Edwin S. Rothschild
Energy Policy Director
Citizen Action

before
the

Committee on Governmental Affairs
United States Senate

on the

Increase in Home Heating Fuel Prices

January 16, 1990

Mr. Chairman and members of the Committee. My name is Edwin S. Rothschild and I am the Energy/Environment Policy Director of Citizen Action, a nationwide consumer organization with over 2 million members. We very much appreciate the invitation to testify today on the problems surrounding the skyrocketing price of heating oil and other fuels.

Summary

December's rapid run-up in home heating oil prices, particularly in the Northeast, is unconscionable and requires Congressional action to both correct the conditions that permit major oil companies to gouge consumers and to provide emergency funding to help low-income consumers pay to heat their homes.

It is obvious to everyone that the extremely cold weather during December sent demand for home heating oil and other fuels soaring. What is not so obvious is the fact that the nation's major oil companies have deliberately created the supply and operating conditions that make the nation economically vulnerable to minor supply disruptions. The major oil companies not only entered the winter heating season with insufficient heating oil inventories, but seized on the colder-than-normal weather to drive wholesale and retail prices to the highest levels in history. What is not so obvious is that the small number of major oil companies which produce most of the nation's heating oil have used their market power to extract exorbitant profits from economically captive and powerless consumers. This is not the marketplace at work, this is out and out robbery.

But consumer outrage should not only be directed at the major oil companies. If nothing else, these companies have behaved in a logical and consistent fashion. Consumer outrage should also be directed at the Bush Administration and elected officials who have failed in their duty to protect the public welfare. The Administration was warned of likely problems this winter, but did nothing. And as prices escalated, the Bush Administration not only refused to grant Jones Act waivers to tankers carrying needed fuel supplies to the Northeast, but had the temerity to propose a 25% cut in federal fuel assistance for the poor and low-income.

But Congress also shares some of the blame. Many in Congress, by their previous actions or inaction, have sanctioned and perpetuated the anti-competitive structure of the oil industry. Many members of Congress have supported previous proposals to cut the budget for the low-income energy assistance program. To shift responsibility and to defer action, numerous politicians have called for investigations by the Justice Department or Federal Trade Commission, knowing full well that such investigations will result in no substantive changes. Instead of trying to gain media attention by attacking an easy culprit, governors and members of Congress should spend their time working for policies and legislation that will provide immediate help to those who cannot afford to heat their homes and establish supply reserves, as you have advocated Mr. Chairman, or minimum inventory levels that have been suggested by others.

Price Gouging Isn't A New Phenomenon

Periods of rapidly escalating energy prices, be it heating oil, gasoline, propane or crude oil, are not new. Over the past 15 years, there have been numerous instances of rapid oil price escalations. Many of these price rises were precipitated by minor disruptions in the marketplace. The gasoline price hikes that followed the Exxon *Valdez* disaster is a recent example. In many instances, a minor disruption in supply has led to supply manipulation and hoarding and price speculation and gouging.

Six years ago cold weather in December and January also drove up demand for home heating oil. Just before the 1983-84 winter heating season, the Energy Information Administration had confidently predicted:

> Despite lower distillate inventories than any end-of-August levels in the last decade, ample time, refining capacity, crude oil stocks, and import capability exist to generate sufficient supplies to meet expected winter demand. These demand projections are predicated on an average retail price for No. 2 heating oil about 9 cents per gallon less than last winter's average of $1.16 per gallon.[1]

Unfortunately, the Energy Department's prognosticators were very wrong. Weather conditions were far worse than anticipated. Moreover, despite the existence of excess refinery capacity, excess crude oil and availability of imports, the major oil companies utilized these supply alternatives too late to prevent a sharp run-up in price.

The heating oil price increase of 1983-84, which raised prices by about 10 cents per gallon between December and February, also brought about demands for a Justice Department investigation. On September 17, 1984 the Department of Justice released the results of its "investigation," for which neither oil company executives nor documents were subpoenaed. The Justice Department's alleged investigation

> revealed no evidence, direct or indirect, of price fixing or other anticompetitive behavior. Rather, our investigation led us to conclude that the price increases resulted from a sharp surge of demand for No. 2 heating oil due to unexpectedly cold weather during late December and January, combined with low mid-winter inventories, and a weather-related shutdown of Gulf Coast refineries that supply the northeast. We concluded that the ***price increases were a result of normal, competitive market behavior, rather than anticompetitive agreements among competitors.***[2]

I doubt very much that the free market orientation of the Justice Department's antitrust division has changed all that much. The Justice Department cannot be trusted.

It has shown itself unwilling to look closely into the operation of the domestic oil market, despite numerous examples of anticompetitive activity. If there is to be an investigation, Congress should conduct its own, using subpoena power to acquire documents and compel testimony from oil industry witnesses.

The Vulnerable System: Keeping Inventories Tight

The major oil companies did not enter the heating season with sufficient middle distillate oil in primary storage. This is the primary reason why heating oil prices have skyrocketed. Had the companies produced more fuel oil prior to November 1, there would have been a larger cushion to deal with the extremely cold weather which sharply increased demand, constrained delivery, caused temporary outages and created panic buying on the futures market and in the spot market. A larger cushion of supply would have moderated the price increases. [See Figure 1]

The Energy Information Administration reported that oil companies failed to build inventories during the summer as is the normal practice.

> Substantial stockbuilding usually occurs during the summer months in preparation for the winter heating season. During the summer of 1989, however, significant buildups occured only in July and September. Demand during the second and third quarters of 1989 was higher than in recent years, helping to slow the stock buildup.[3]

Middle distillate inventories at the start of the winter heating season were 119.1 million barrels, the lowest point in in years.

Another way of analyzing the condition of available inventory is to calculate the days supply. First, we must recognize that the National Petroleum Council estimates minimum inventory levels of 85 million barrels. This amount is not available to the market. Thus, available supply measured in days of supply is that amount of inventory less the minimum divided by current demand. By the end of December primary inventories accounted for about 6 days of supply. [Figure 2]

In early November the EIA released its 4th Quarter Short-Term Energy Outlook (STEO). The EIA assessed the likely consequences of severe colder-than-normal weather conditions.

> The implication of such conditions for distillate fuel demand...could...amount to an additional 140,000 barrels per day in the fourth quarter and 170,000 barrels per day in the first quarter (for a winter average of 155,000 barrels per day), compared to base case levels.[4]

The EIA forecast did not appear very confident about the industry's ability to meet the higher demand levels of a severe winter. The higher demand could not be met by stock drawdowns, because said EIA "the use of primary stocks has become less important in suplying winter demand for distillate." The increase in supply would have to come from imports and increased refinery utilization and refinery yields.[5] Three weeks later the EIA reported that "international demand for distillate fuel oil was strong, further straining limited supplies."[6] To increase distillate production, said EIA, "would require an extraordinary level of domestic refining output. Capacity utilization over the winter months is projected to average 87 percent, already the highest utilization rate for any previous winter. Meeting the additional demand for distillate would require a level of utilization averaging close to 90 percent...Certainly refinery yields of distillate would have to increase." The EIA also recognized that if refiners had to increase middle distillate yield, it would come "at the expense of other products."[7]

To understand why home heating oil prices have nearly doubled, it is critical to ignore oil company propaganda and examine what the companies have been doing. In the first place, it is quite clear that demand for middle distillate fuel has been increasing. Ordinarily, under such circumstances, oil companies should be increasing, not decreasing inventory levels. Clearly, readily available distillate inventories, unlike increased refinery production and/or imports, provide consumers with the best protection against a sudden cold spell and a sharp increase in price. But as the data indicates, the major oil companies have chosen a strategy to keep the system tight, to keep supply and demand in a precarious balance.

With the sudden, extended cold spell, inventories were not available to the extent needed. Thus, the companies were forced to increase refinery production and obtain imports. But both of these efforts proved difficult. As refiners increase refinery utilization, they run greater risks of refinery breakdown, especially when there is little excess capacity. The explosion at Exxon's refinery is a case in point. For the last few years demand has begun to outstrip refinery production. [Figure 3]

The companies could easily have produced sufficient heating oil prior to the onset of the heating season. A small increase in refinery utilization and a refinery shift toward middle distillates could have, at a minimum, produced enough fuel to reach last year's level. But, by entering the heating season with inadequate inventories, supply had to be made up primarily from production. Thus, as more crude oil was made into home heating oil, production of jet fuel and gasoline declined, which has allowed the companies to increase prices for both of these products as well.

The impact of rising home heating oil prices has substantially increased oil company margins. Here are two examples:

EXXON

DATE	WHOLESALE PRICE	CRUDE COST	MARGIN
December 1	$26.83/bbl	$20.30/bbl	$5.53/bbl
December 29	$47.42	$21.50	$25.92
% Increase	+78%	+6%	+315%

Source: Journal of Commerce, Platts Global Alert Merc Close

SUN

DATE	WHOLESALE PRICE	CRUDE COST	MARGIN
December 1	$26.98	$20.30	$6.68
December 29	$47.88	$21.50	$26.38
% Increase	+77%	6%	+295%

Source: Journal of Commerce, Platts Global Alert Merc Close

Comparing what happened in 1983-84 with the current situation, one can see a similar pattern. Crude oil costs remained stable. Retail margins remained stable, but refiner margins increased. Figure 4 shows that the average refiner margin doubled between November and December according to preliminary figures.

When heating oil prices increase as they have, many consumers tend to blame their local heating oil dealer. Based upon conversations with Citizen Action heating oil co-ops in four states -- Massachusetts, Connecticut, New York and New Jersey -- it is quite clear that many dealers are absorbing some of the increases and not passing them on. While there may be a few retail dealers who are taking advantage of the situation, by and large, the vast majority are trying to restrain their prices.

This is not true for the major oil companies. These companies are simply selling their middle distillate fuel at prices the market can bear. These companies have absolutely no concern for the plight of consumers whose heating bills will increase by between $300 and $500, mostly because of the price increase rather than the increased usage.

Blame It on the Weather, Blame It on the Market, But Don't Blame It on Us

Spokesmen for the nation's major oil companies, the companies that manufacture and sell most of the nation's heating oil or middle distillate fuel like to argue that these kinds of things happen in a free market, that markets accurately reflect supply/demand conditions, that oil is a commodity and that it's best to keep the government out of the oil market. All of these are, if nothing else, self-serving. These arguments imply that oil companies, when left alone, can handle the job, whatever that job is. Well, we all know propaganda when we hear it. The fact is that what is in the interests of Exxon, Amoco, Mobil, Chevron, Texaco and its partner Saudi Arabia is not often, if ever, in the interests of heating oil or gasoline consumers.

The structure and operation of the oil industry has changed a great deal over the last ten years. In the first place mergers, acquisitions and consolidations have not only left fewer competitors in most major U.S. markets. According to Energy Information Administration data from 1983, just four companies controlled between 50% and 95% of wholesale heating oil markets in most states. Similarly eight companies controlled between 72% and 100% of wholesale heating oil markets. But a spate of additional mergers and acquisitions has occurred since 1983. These consolidations have reduced the number of companies in the marketplace even further. Moreover, it is quite likely that these mergers have also reduced the availability of primary storage.

Higher interest rates, increased debt load and a host of other factors has encouraged companies to keep their inventories as lean as possible. Furthermore, the dangerous combination of leveraged buy-outs, acquisition mania, junk bonds and Wall Street financial manipulation has shifted oil company investment strategy to maximizing short-term profits. As a result less money is spent on holding inventory, maintenance, safety, and other costs that do not directly yield the necessary bottom line number. People like T. Boone Pickens, Robert Kravitz, Carl Icahn, Ivan Boesky, Michael Milliken, taking advantage of current tax and other laws, wittingly or unwittingly, have forced many U.S. companies, including many U.S. oil companies, to change their financial priorities. When oil industry managers have to spend more and more of their time working on defending against unfriendly takeovers or planning a takeover of their own, they do not spend enough time and money on research, development, maintenance and safety.

Clearly, the economics of less competition and short-term profit lie at the root of Exxon's many recent oil spills and explosions and the Phillips Oil Co. chemical plant explosion as well as decisions to hold less inventory and limit expansion of refinery capacity to meet growing demand. For major oil companies as a group to enter the winter heating season with 10 million barrels less middle distillate inventory than they did last year was a deliberate economic decision. Because of the decline in competition, it may be a strong indication of market power. In a competitive market, there would be differing strategies with some companies deciding to expand their stocks, with others maintaining levels and some deciding on putting less in inventory.

Leaving aside the question of whether the companies colluded in their inventory behavior, let's examine the oil industry's arguments for why home heating oil prices have shot up to the highest level in history, even higher than in 1981 or 1984. The colder-than-normal winter weather is named as the number one culprit. While there is no doubt that the record or near-record cold wave that hit many portions of the United States sharply increased demand for heating fuels, the increase in price for these fuels differed markedly. The cold weather is measured in heating degree days. According to the National Weather Service the number of heating degree days for the last six months of 1989 were 243 above normal and 204 above last year. For home heating oil this translates on a nationwide basis to an increase in demand for approximately 204,000 barrels per day over last year* according to the Energy Information Administration. There are similar heating degree day/demand factors for natural gas, propane and electricity.

If the colder December weather had the same effect on increasing demand for all heating fuels, why have home heating oil prices risen much higher and faster than natural gas prices, in many markets a competing fuel? Under present law, prices for both fuels are determined in the market place, not by the Federal Government. The spot price of natural gas between November 1 and January 1 has increased from roughly $2 per MMBtu to $2.50 per MMbtu, an increase of 25%. According to data collected by *Inside FERC's gas Market Report* between Nov. 1 and Jan. 1 the median city-gate price of spot gas in the New York/New Jersey area rose from $2.375 to $2.565, an increase of less than 10 percent. In Northeast Ohio, the spot price increased from $2.425 on Nov. 1 to $3.175, a 30 percent jump. For the area of Northern Illinois/Southern Indiana the spot price increased from a median of $2.02 to $2.73, a 35% gain. The spot price for heating oil in New York Harbor spiraled by a whopping 67 percent over the same time period from about 60 cents a gallon to over $1 a gallon. The heating oil price incorporates the cost of crude oil, refining and delivery to New York Harbor and the gas price reflects delivery into a pipeline system for delivery north. Neither price incorporates distribution costs. On a delivered-to-consumer basis the increase in heating oil prices is much greater.

If weather conditions were the sole determinant for fuel price increases, it is logical to assume that price increases for home heating oil and natural gas would be comparable. Because price increases have been much greater for home heating oil, there must be more to the story than weather. While the weather may account for nearly all of the increase in natural gas prices, on a Btu equivalent basis it only accounts for a small portion of the increase in heating oil prices. The answer must lie elsewhere.

Well, if the weather can't be blamed, what about low water levels on the Rhine, or the Exxon refinery explosion in Louisiana or other disparate events? Oil industry spokesmen point out that market conditions in Europe have reduced fuel imports into the United States. While that may be true to a certain degree, it fails to address the issue of European refinery capacity utilization and production of middle distillate fuels. Major oil companies in the United States -- Exxon, Shell, BP, etc. -- also refine large volumes of oil in Europe and in other foreign countries. There is still surplus refinery capacity in Europe. Not only that, most European refineries are set up to produce more middle distillate fuels and gasoline, unlike refineries here in the US. Thus, at a minimum there needs to be a much closer examination of foreign refinery operations, before allowing oil company spokesman to claim that there is "insufficient product" available from European or other foreign refineries.

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* One additional heating degree day is equivalent to an additional 1,000 barrels per day of heating oil demand.

Some argue that costs have increased. They point to rising crude oil costs and increased costs of refinery operations. In point of fact, crude oil prices have only increased slightly and only in response to rising product prices. Moreover, as oil companies increase refinery utilization, their costs go down, not up.

Lastly, oil company executives say that they are only responding to the market and that they are selling heating oil at a price the market will bear. They say that their prices reflect the price set in the spot and futures markets over which they have no control. They say they are fulfilling their contractual obligations and are increasing their production of middle distillate fuel to meet demand. They say they are doing everything possible to provide fuel to their customers at a time of severe market and weather conditions.

This answer comes closest to the truth. The market conditions in the heating oil market do determine price levels. Businessmen in pursuit of profit will seize any and every opportunity market conditions provide to earn greater profits. Oil companies will take advantage of their market power to limit supplies and drive up prices. And this is precisely what they have done and what the Congress and the White House have allowed the companies to do.

A callous, cynical oil executive, like Ted Eck, Amoco's chief economist, doesn't believe that "anyone can effectively stabilize normal swings in the price of petroleum, any more than we can dictate the 'correct' price of copper, soybeans, or Amoco stock."[4] But heating oil is not an ordinary commodity. It is a necessity of life. If the orange crop freezes and prices skyrocket, consumers can easily avoid buying oranges. If Amoco stock takes off, consumers can ignore that fact without any fear for their health or welfare. Heating oil has more in common with utility service than with soybeans or Amoco stock. States require electric and gas utilities to demonstrate that they have the capacity to serve their customers on peak demand days. This is so customers can obtain reliable service at reasonable prices.

Inasmuch as this is the second time in the last year that we have experienced a sudden and sharp increase in the price of a petroleum product, perhaps it might be appropriate for the Congress to take a look at the structure and operation of the petroleum industry and to devise some programs that will protect consumers from future supply manipulation and price gouging.

The Politics of the 1989-90 Heating Oil Crisis

This winter's frenzy in the oil markets is no different from previous examples and should come as no surprise to the nation's political leaders. The total decontrol of oil markets, the failure to stem or prohibit anticompetitive mergers, acquisitions and consolidations in the oil industry, the refusal to create regional petroleum product reserves and other protective measures, the callous disregard for the plight of the poor in repeated cuts in the Low-Income Home Energy Assistance Program (LIHEAP) and the unwillingness to appropriate and spend money on weatherization and improvements in energy efficiency are at the core of this winter's meteoric rise in fuel prices. In other words, Congress, the Bush administration and the Reagan administration before it and many governors and state legislatures are really to blame for leaving consumers vulnerable to supply manipulation and price gouging by the major oil companies.

Two months ago most consumers were paying about 90 cents a gallon for home heating oil, but are now paying between $1.30 and $1.50 a gallon. These prices are higher than any other time, even higher than the winter of 1983-84 when prices reached about $1.25 per gallon.

Without a doubt, the major oil companies are taking advantage of a situation they helped to create. But this is precisely the way markets and oligopolistic business enterprises work. The major oil refiners have every incentive to boost prices and realize exorbitant profits on refining middle distillate and other fuels. That the major oil companies engage in charging the highest prices possible in a panicked market is not a new phenomenon. What is new is the cynical way in which public officials are trying to shift or avoid responsibility for sanctioning the policies which allow these companies to get away with what in any other situation would be deemed criminal behavior.

Consumers should not be fooled by the kind of political grandstanding that has become a popular substitute for responsible action. It does consumers no good for governors, senators and representatives to call for investigations by the Department of Justice or the Federal Trade Commission. The script for such so-called "investigations" has not only been written, but has been performed many times. These agencies agree to look into the problem, then analyze some numbers, talk to some oil analysts and oil industry executives and then issue a report. If it's on heating oil, you can be sure the report will be published sometime in July, August, or September when everyone's attention is focused on staying cool not warm. And the conclusion of this report will be that "market forces" were at work and that, while there may have been some isolated instances of price gouging, there was no evidence of collusion or conspiracy. Politicians, in the meantime, will have demonstrated their concern to outraged constituents and conveniently shifted the responsibility "to do" something to another party.

Senators, members of Congress, state attorneys general and state legislatures should be conducting their own investigations, using subpoena power to uncover wrongdoing in the oil industry. By relying on an administration whose political past and future depend so heavily on support from the major oil companies, it is illogical to expect the kind of investigation that will closely examine the role played by these companies in driving up prices.

Recommendations

Mr. Chairman, establishing regional petroleum product reserves would provide a measure of insurance for just such an event. Legislation that amends the Energy Policy and Conservation Act to expand the Strategic Petroleum Reserve to include regional product reserves would be the appropriate vehicle. We would also recommend legislation prohibiting mega-mergers in the oil industry and limitations on further downstream integration by foreign governments into our domestic petroleum sector. Furthermore, increased funding for LIHEAP and other programs that would have, if not prevented, at least moderated, December's heating oil havoc are also critical.

To deal with the current situation, Citizen Action urges Congress to immediately pass emergency legislation to provide sufficient funds to low-income families living in states that have exhausted their assistance funds. Moreover, we urge Congress to reject President Bush's misanthropic proposal to cut the LIHEAP budget by 25 percent. Instead of cutting LIHEAP, Congress should increase the appropriation by 50 percent.

The President should immediately reverse the decision of the Maritime Commission denying Jones Act waivers to foreign-owned tankers. This disgraceful act not only demonstrates a total lack of concern for the people of the Northeast, but also that the President has not made this problem a priority issue. The severe winter weather and its consequences is not very different from the disruptions caused by Hurricane Hugo or the San Francisco earthquake. All are calamaties and all require emergency responses.

In addition to supporting passage of H.R. 3193, we believe that together federal and state governments need to require oil refiners and distributors to establish and maintain minimum inventory levels for home heating oil in order to provide a margin of safety for any future market disruption.

For the longer term, we must have programs and appropriations that speed the further development of energy efficient technologies so that we can become much less dependent on oil and the destructive vagaries of oil industry behavior. Because we can further reduce our consumption of oil and other fuels through improvements in energy efficiency, Congress should double the federal research, development and demonstration for energy efficiency.

TESTIMONY OF
HONORABLE CLARINE NARDI RIDDLE
ATTORNEY GENERAL, STATE OF CONNECTICUT
BEFORE THE
UNITED STATES SENATE
GOVERNMENT AFFAIRS COMMITTEE

JANUARY 16, 1990

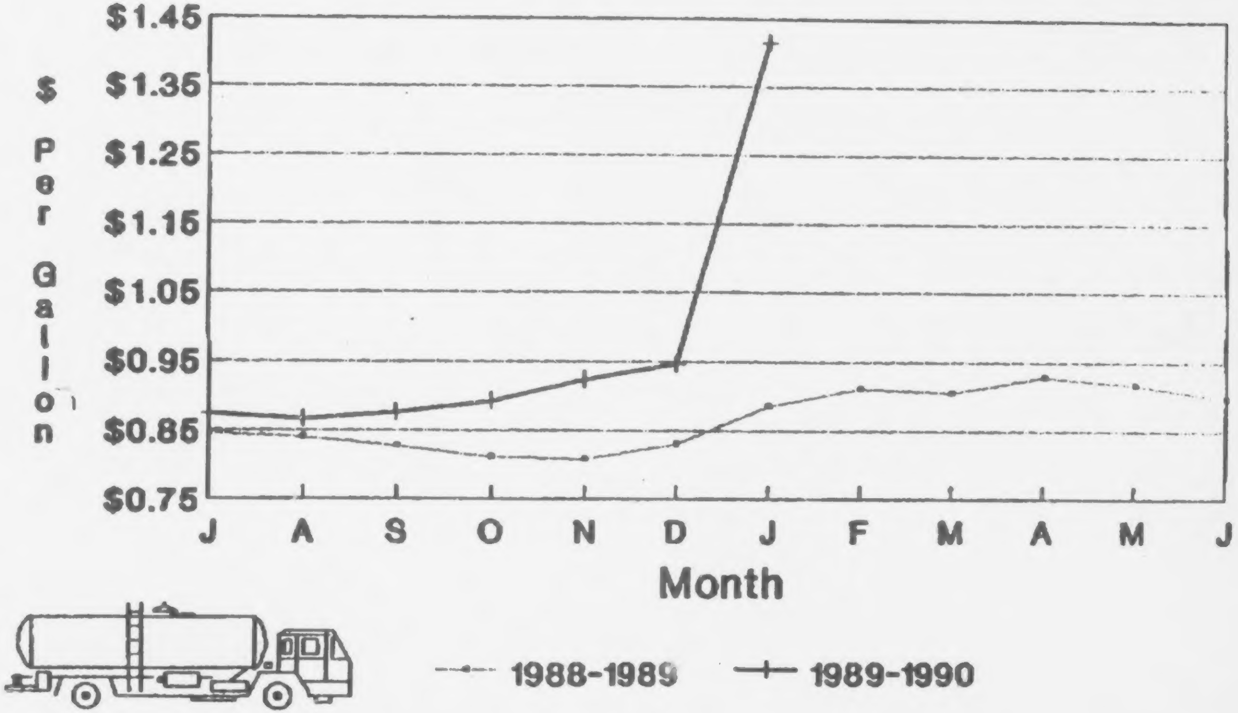
Mister Chairman and distinguished members of the Senate Government Affairs Committee:

My name is Clarine Nardi Riddle and I am Attorney General of the State of Connecticut. I am deeply appreciative of the opportunity to express to this Committee my views on the home heating oil crisis in this nation. I am particularly honored to be able to address these concerns to my predecessor and friend, the former Attorney General of the State of Connecticut, Senator Joseph I. Lieberman, who proved himself over and over again to the people of Connecticut as a great advocate for consumers, the poor and the elderly.

In the month of December, 1989, Connecticut consumers experienced a shock wave: the precipitous rise in the price of home heating oil. The average retail price for home heating oil on December 5, 1989 was 94.7 cents. By January 3, 1990, the price had risen nearly 47 cents, to $1.416!

Heating Oil Retail Price

OPM Energy Monthly Survey



We in Connecticut, as in the rest of the Northeast, are particularly dependent upon fuel oil to keep ourselves warm and to keep our businesses running. In fact, 60 per cent of Connecticut homes heat with oil.

This abrupt increase in heating oil prices is having a serious impact on Connecticut families, especially those on fixed incomes, and on the poor and the elderly, on small businesses, municipalities and state government itself.

Our Energy Division has estimated that it will cost Connecticut residents approximately $65 to $70 million more because of these price increases . . . and if oil prices remain high, this number will increase dramatically.

The fiscal impact upon state government and our energy assistance program for low-income families is truly devastating. Every penny that heating oil rises in price adds $200,000 to the state's annual bill for heating its own buildings and for providing low-income energy assistance.

The citizens of Connecticut are outraged, as they should be. The State of Connecticut has pledged to find the causes of this crisis, to report the results to our citizens and to prosecute any wrongdoing that we find.

We are well into our investigation of the crisis. Governor William A. O'Neill established a strike force including our Energy Under-Secretary, our Consumer Protection Commissioner and me. We have already obtained responses to a questionnaire submitted to 28 companies doing business in Connecticut that included every significant refiner, supplier and wholesaler.

We are currently analyzing the responses to those questionnaires. We have already found that some participants at each level of the industry -- refiners, wholesalers and retailers -- have increased their profit margins during the crisis.

Because we already anticipate that we will need to ask further questions and because, quite frankly, some of the responses from the companies were less illuminating than we had hoped, we expect our next series of questions to include formal subpoenas that target all portions of the heating oil market -- refiners, wholesalers and retailers.

Our inquiry will not just target what happened during December. We will be watching closely to see if prices drop as quickly in response to market conditions as they rose.

Because there were some problems with the propane market, which supplies heat to some 13,000 homes in Connecticut, including instances of commercial customers actually running out of fuel, we will also be asking questions of the companies that supply propane to Connecticut.

We are proceeding along three parallel tracks. First, we are looking for indications of classic antitrust conspiracy related to horizontal manipulation of either price or supply. Second, we are examining the applicability of a Connecticut statute that may be unique in the country, one that prohibits the illegal creation of a fuel shortage.

Unlike antitrust theory, this statute makes unlawful unilateral contrivances of the fuel oil supply that are aimed at raising prices to consumers. This statute carries with it severe criminal penalties and civil liability, five years in jail, $250,000 fines and treble damage recoveries for consumers. And third, we're looking at price gouging under our Little Federal Trade Commission Act. We believe that merchants may not exploit market situations in an essential commodity by increasing profit margins to unconscionably high levels.

But, as we all know, the problem is not Connecticut's alone. Our state's resources are limited, as are those of most states. Despite our knowledge, experience and ability to coordinate with other states through the Eastern States Antitrust Committee and the National Association of Attorneys General, Multistate Antitrust Task Force -- and we are beginning that coordination and Connecticut has accepted a leadership role on behalf of the other states -- I nevertheless encourage the widest ranging inquiry by both the legislative and the executive branches of the federal government.

It is state attorneys general who return moneys to consumers in both antitrust and consumer protection cases. If we find evidence of price gouging or the illegal creation of a fuel shortage, you can be assured that we will sue to return to Connecticut consumers what is rightfully theirs.

Historically, however, states have relied to a great degree upon the executive branch of the federal government to investigate national and international antitrust conspiracies to provide the facts necessary for the states to institute civil suits to recover damages for themselves, their municipalities and their consumers.

Regrettably, based on the Exxon Valdez incident and what I perceived as a lack of vigorous action by the Justice Department and the Federal Trade Commission during that crisis, I am hesitant to wait for the executive branch of the federal government to get to the bottom of the crisis. Therefore, until we receive clear signals of a vigorous executive branch investigation, we must continue with our mission.

The ultimate irony, of course, is that if, perchance, a horizontal price fix is found at anything other than the retail level, most consumers in this nation will get absolutely nothing! The 1977 United States Supreme Court decision, Illinois Brick v. Illinois states that only direct purchasers from price fixers may sue to collect damages.

The current heating oil crisis points out the folly of Illinois Brick. Heaven help us if a price fix is found by the Justice Department, the FTC or any state attorney general at the wholesale or refiner level of the industry. Consumers in this country will rebel! It is time for the Congress to pass legislation repealing Illinois Brick.

I have attached to my testimony our questionnaire which we sent to 28 refiners, wholesalers and suppliers in order to elicit at least rudimentary information with which to launch our inquiry. I have also attached a copy of Section 16a - 17 through 20 of the Connecticut General Statutes concerning the illegal creation of a fuel shortage, and a copy of a New York Times article authored by Assistant Attorney General Robert M. Langer of my office . . . that explains the Illinois Brick case.

Thank you so much for permitting me to address this Committee. I would be pleased to answer any questions that members of the Committee might have.

State of Connecticut

CLARINE NARDI RIDDLE
ATTORNEY GENERAL

Office of The Attorney General
55 ELM STREET
P.O. BOX 120
HARTFORD, CT 06101
TELECOPIER (203) 566-1704

December 28, 1989

To: Connecticut Home Heating Oil Suppliers and Wholesalers

Dear Supplier or Wholesaler:

Governor William A. O'Neill has asked Bradford S. Chase, Undersecretary, Energy Division, Office of Policy and Management, Mary Heslin, Commissioner, Department of Consumer Protection, and me to review wholesale marketing and pricing practices of the fuel oil industry within this state.

The abrupt increase in home heating oil prices in the past several weeks is having a very serious impact upon Connecticut families, especially those on fixed incomes -- the poor and the elderly, as well as small businesses, municipalities and state government.

Because of the severity of the problem, the Governor has asked us to report back to him in the shortest possible time frame.

In order to facilitate our task, we are requesting certified responses to the attached questionnaire no later than seven (7) days from today, **Thursday, January 4, 1990.** A certification form to be attached to your responses is enclosed herewith.

Confidentality of individual company data will be strictly maintained by us to the fullest extent required by law. Thus, it is important to complete the confidentiality request form enclosed herewith.

Inquiries about this questionnaire may be directed to Joseph Belanger of the Office of Policy and Management. Mr. Belanger may be reached at (203) 566-2800.

Very truly yours,

Clarine Nardi Riddle

CLARINE NARDI RIDDLE
ATTORNEY GENERAL

CNR:md
Encs.

Connecticut Home Heating Oil Supplier and Wholesaler Questionnaire

1. Please set forth each factor which has contributed to the rise in your #2 fuel oil prices since November 1, 1989. Please list each factor in order of significance of effect.

   For each factor, set forth a detailed explanation of how, and to what extent it has contributed to the rise in #2 fuel oil prices. Provide all documentation to support your answer.

2. Describe any changes in your #2 fuel oil inventory policies and practices between 1984 and the present.

3. Please list your #2 fuel oil inventory levels for each week between October 1 and January 31 for the heating seasons 1985-1986 through 1988-1989 and for each week between October 1, 1989 and the present.

4. For each heating season from 1984-1985 through 1989-1990 separately set forth what percentage of #2 fuel oil sold by you was obtained through (1) your own refining, (2) under purchasing contract, (3) from the spot market and (4) other (specify). (For 1989-1990, please provide data for season to date and estimates for the season as a whole separately).

5. Please set forth separately for each terminal operated by you or your affiliates within the continental U.S., the location of such terminal and the posted price of #2 fuel oil for each day between December 1, 1989 and the present. If more than one posted price was in effect on any day, please set forth each such price separately.

6. Please list your average gross margins in cents per gallon for #2 fuel oil on continental U.S. sales for each day between December 1, 1989 and the present. Also, provide average gross margins on a daily basis for a comparable period last year. Gross margins are defined as posted price minus cost of product sold.

5244L
12-28-89

CONNECTICUT HOME HEATING OIL SUPPLIER AND WHOLESALER QUESTIONNAIRE RESPONSE CERTIFICATION

I, the authorized representative of _________________, do hereby certify, under oath, that, under penalties for false statement under Section 53a-157 of the Connecticut General Statutes, the information contained in the foregoing response to the Connecticut Home Heating Oil Supplier and Wholesaler Questionnaire has been examined by me, and to the best of my knowledge and belief is complete, and the statements made herein are true and accurate.

____

[Authorized Representative
of ________________]

Sworn and subscribed to, before me, this ___ day of ________, 19__.

____
Commissioner of the Superior Court

Notary Public
My Commission Expires ________________

REQUEST FOR PROPRIETARY TREATMENT

I, the authorized representative of the ____________________ do hereby request confidential proprietary treatment of the information conveyed to the Connecticut Office of Policy and Management, Energy Division in response to the Connecticut Home Heating Oil Supplier and Wholesaler Questionnaire that meets the requirements for confidential proprietary treatment under Section 16a-14 of the Connecticut General Statutes.

____

(signature)

____

(title)

____

(date)

CHAPTER 296

OPERATION OF FUEL SUPPLY BUSINESS

Sec. 16a-17. Definitions. As used in sections 16a-17 to 16a-20, inclusive

(1) "Fuel" includes electricity, natural gas, petroleum products, coal and coal products, wood fuels, radioactive materials and any other resource yielding energy.

(2) "Creating a fuel shortage" means the diminution by contrivance or artificial means of the supply of fuel to a point below that needed to meet consumer demands adequately

(P.A. 74-208, S. 1, 5.)

Sec. 16a-18. Illegal creation of fuel shortage. Penalty. Extradition. (a) No person, firm, corporation, business or combination thereof shall individually perform any act, or conspire to perform any act, which act creates a shortage of fuel or a probable shortage of fuel in this state with the intent to raise fuel prices or energy prices, adversely affect competition in this state or in any way violate the anti-trust laws of the state of Connecticut or other laws of this state regulating illegal business practices

(b) Any person, firm, corporation, business or combination thereof, violating any provision of subsection (a) shall be fined not more than two hundred and fifty thousand dollars or imprisoned not more than five years, or both

(c) If any person violates sections 16a-17 to 16a-20, inclusive, and subsequently leaves the jurisdiction of this state, the chief state's attorney shall seek extradition of such individual. If any individual violates any provision of said sections while physically present in another state, the chief state's attorney or his designee shall seek extradition of said individual under a like provision of section 54-162 of the Uniform Criminal Extradition Act, as it may appear in other jurisdictions or under any other applicable law of such other jurisdictions

(P.A. 74-208, S. 2, 5.)

Sec. 16a-19. Powers of investigation. Section 16a-19 is repealed

(P.A. 74-208, S. 3, 5; P.A. 75-537, S. 12, 55; P.A. 76-435, S. 53, 82; P.A. 77-614, S. 19, 610; P.A. 81-330, S. 12, 13.)

See Sec. 16a-5 for secretary's investigatory and subpoena power.

Sec. 16a-20. Enforcement, civil action privileged, damages, reciprocity. (a) The office of policy and management may institute a civil action in the superior court, or in the United States district court, where applicable, against any person, firm, corporation, business or combination thereof it believes, or has reason to believe, has violated sections 16a-17 to 16a-20, inclusive, to enjoin said parties from continuing such conduct within this state and to seek repayment of damages on behalf of those individuals, businesses and industries harmed by said activities. In such actions it shall be represented by the attorney general.

(b) Upon the institution of such civil action, the attorney general shall have the right to take the deposition of any witness he believes, or has reason to believe, has information relative to the prosecution of said action, upon application made to the superior court, notwithstanding the provisions of other statutes limiting depositions. The attorney general shall also have the right to take such depositions in other states and to utilize the laws of said other states relative to the taking of depositions where allowed by the laws of those states. The state of Connecticut shall allow similar depositions to be taken within this state on behalf of any governmental agency of another state or any territory or possession of the United States seeking to pursue litigation similar to that permitted under sections 16a-17 to 16a-20, inclusive, so long as such other state allows the attorney general to take depositions within its jurisdiction. In so doing, the superior court shall enforce the orders of the courts of such other state relative to the deposition requested and issue subpoenas or subpoenas duces tecum, as necessary, as well as enforcing said subpoenas through citations of contempt or other available remedies.

(c) In any case where damages referred to in subsection (a) of this section shall be proven by a fair preponderance of the evidence, the court shall order repayment by any or all defendants of said damages to the applicable parties or businesses through the office of policy and management.

(d) The court shall also have the right, in its discretion, to assess treble damages against said defendants.

(e) Any such civil action shall be privileged in assignment for trial.

(P.A. 74-208, S. 4, 5; P.A. 75-537, S. 13, 55; P.A. 77-614, S. 19, 610.)

History: P.A. 75-537 replaced Connecticut energy agency with department of planning and energy policy; P.A. 77-614 replaced department with office of policy and management.

CONNECTICUT OPINION

Assembly Must Fill The Antitrust Void

By **ROBERT M. LANGER**

> Other states have acted to protect their consumers.

TRY your hand at antitrust law: Competing manufacturers of television sets illegally agree to overcharge retail merchants $100 for every set the retailers buy. The retailers unwittingly pass along the entire $100 overcharge to unsuspecting consumer purchasers. Who has the right to sue to collect damages from the manufacturers?

If you say the consumers in Connecticut, you fail. If you say the consumers in Mississippi, you pass. If you say the retailers, you also pass.

In 1977, the Supreme Court of the United States ruled in Illinois Brick Company v. Illinois that, with limited exceptions, only someone who buys *directly* from a price fixer may sue to collect damages under Federal law. Most price-fixing cases, however, are filed against manufacturers who are at least two steps removed in the chain of distribution from the consumer.

Because of the Illinois Brick case, hundreds of millions of dollars have remained firmly in the pockets of price fixers. Numerous lawsuits brought by consumers and state attorneys general have been dismissed or settled for small sums because purchases have been "indirect."

Moreover, consumers, states, towns and other "indirect" purchasers have, for the most part, simply stopped bringing new price-fixing suits for damages against manufacturers. Since some 95 percent of all purchases by state governments are through middlemen rather than directly from manufacturers, the overcharging or price fixing is indirect to the state; a suit would do little good.

The Illinois Brick decision is nothing short of logic turned on its head. Indirect consumer purchasers have no right to sue, yet they are the ones who ultimately suffer the economic injury which results from antitrust overcharges. Paradoxically, the direct purchaser (usually a wholesaler) often receives an extraordinary windfall. He passes on the overcharge to the consumer, and then is eligible to collect *three times* the amount of the overcharge in damages.

Since 1977, Congress has repeatedly failed to "repeal" the Illinois Brick decision by amending the Federal antitrust laws. State antitrust statutes have thus become the last hope for consumers seeking redress from anticompetitive abuses.

On April 18, the Court ruled, 7 to 0, that a state, can permit indirect purchasers to sue and collect triple damages. Indeed, 15 states, including California, Mississippi and Rhode Island already provide for indirect purchaser recoveries.

But not Connecticut! The General Assembly has on at least four occasions, failed to adopt legislation to permit the state, municipalities and consumers, as indirect purchasers, to collect damages under Connecticut law. The excuse that the legislation would be unconstitutional has now been demolished by the Court. Connecticut, by its inaction over the years, has created a haven for bid-riggers and price-fixers. Not only are the state, towns and consumers hurt, but so are the overwhelming majority of honest businesses.

The Illinois Brick case, because of its inherent illogic and gross inequity, fosters an unhealthy disrespect for the law. As Dickens wrote in "Oliver Twist," "If the law supposes that, the law is a ass."

The Connecticut General Assembly should act to bring logic and equity back to antitrust enforcement, as so many states have already done. In so doing, it can return to the consumers of Connecticut what is rightfully theirs. ■

Robert M. Langer is the assistant state attorney general in charge of antitrust and consumer protection cases.

JAMES E. TIERNEY
ATTORNEY GENERAL

STATE OF MAINE
DEPARTMENT OF THE ATTORNEY GENERAL
STATE HOUSE STATION 6
AUGUSTA, MAINE 04333

JAMES E. TIERNY
MAINE ATTORNEY GENERAL

Testimony Before Senate Governmental Affairs Committee

January 16, 1990

Good morning Mr. Chairman and Members of the Committee.

My name is James E. Tierney, and I am Maine's Attorney General. Thank you for inviting me to testify today on an issue that has severely affected thousands of Maine citizens. Home heating oil prices have nearly doubled in Maine in recent weeks, and I urge the federal government not only to get to the bottom of this matter, but also to provide immediate assistance to those of Maine citizens who have been forced to shudder in the dark.

At the end of November 1989, home heating oil prices were approximately 80¢ a gallon. By last week, they had risen to as high as $1.50 a gallon. Although Maine has had its share of cold weather over the years, cold weather alone has never caused such a dramatic increase in home heating prices in our state.

Home heating oil is not a luxury in Maine. For people on low or fixed incomes, a price increase of 10¢ a gallon is a hardship, doubling of the price is a disaster. Over 50,000 Maine households receive federal assistance for home heating bills. Nearly half of those who receive assistance earn less than $6,000 a year. The stratospheric increase in home heating prices have lead another 2,000 households to apply for such assistance.

Higher heating oil prices are a burden for all of us. Last year an elderly woman in Augusta had purchased 320 gallons by this time in January. This year she has purchased 435 gallons. If her average heating oil price were $1.20 a gallon this would mean a heating bill in a little over a month of nearly $522. We all face such bills. Today, the price of heating oil in Maine is still as high as $1.30 a gallon.

But most of us are fortunate. We can accommodate by carefully adjusting our monthly budgets. But for the great majority of Maine HEAP recipients this is impossible. 57% of the households in Maine that receive HEAP assistance earned less than $8,000. 47% of those households earned less than $6,000. Applications in Maine for HEAP funds are nearly 2,000 ahead of last year. In 1986 HEAP assisted 60,171 Maine households. Today it is assisting only 50,000.

This assistance is desperately needed. In the last three years, the federal government has cut 30% of the funds available for home heating assistance. Even the oil industry has recommended that more, not less, funds be made available for assistance to those who cannot afford exorbitant fuel bills.

We all sit at kitchen tables on cold winter nights, pencil in hand, and struggle with unyielding bills. But there can be no comparison between the math at your or my kitchen table and the math of a HEAP household. Eventually our budgets add up. The HEAP household's budget never adds up.

Let me give you two actual examples: a family just beginning and a couple far past retirement age. Neither are among the poorest of Maine's poor. In fact, I doubt if either household considers itself impoverished.

Let us call the first household the Youngs. Mr. and Mrs. Young have 2 children and rent a trailer in the country outside of Bath, Maine. Mr. Young has lost his job and is currently on unemployment. His income is $190 per week. Consider the Young's budget mathematics:

1. Rent for their trailer is $400 a month;

2. Their electricity bill is $90-$100 a month (this may seem high but trailers need to wrap their pipes with electric heat tape and the cost incurred is very expensive);

3. Because it is a trailer it has an outside heating tank and is forced to use #1 heating oil, which costs considerably more than #2 heating oil. The Youngs will burn 5-7 gallons a day and 150 gallons a month.

When the math is finally completed each week and their budget finalized, the Youngs will have only $20 left for food.

The second, older couple I will call the Elderlys. If you do not look too closely the Elderlys might seem to be an American ideal. He is 84 and she is 79. They own their own house, mortgage free, in Bath. He is retired from Bath Iron Works, one of Maine's fine employers.

But if we look closer the Elderlys share the same fearful problems as the Youngs. He receives from Bath Iron Works a pension of $56 a month. Their Social Security payment is $773 a month. With a total monthly income of $829 they receive too much money to qualify for either Medicaid or food stamps. Since November 30 the Elderlys have already had to purchase 558 gallons of oil. Their estimated oil bill for October 1 to April 1 is $1,400.

The most HEAP will be able to help the Elderlys is $340. It is true that the Elderlys own their own home. But in order not to waste heat the Elderlys have closed off their upstairs and live only in the kitchen and in the dining room, converted into a bedroom. This December the Elderlys were forced to borrow money in order to buy medicine.

Of course, many Maine households face even more profound hardship than the Youngs and the Elderlys. There is an AFDC family in Lewiston, 2 children, with a monthly income of $500 and a rent of $375. How do they budget for heat? There is a elderly person living alone in Hiram with an income of $360 a month. How does she balance her budget?

What are the strategies of Maine's less fortunate households for surviving this winter?

When the money runs out one family will seek credit from an oil dealer but then not pay. Then the family will go to another oil dealer and not pay it either. And then to another until finally they are brought to court. Other families will abandon their houses and move in with friends. Others will go to the town officials and seek assistance. But for many Mainers this is the harshest result of all. Stories are common of men in tears, desperate for help, but refusing to go "on the town." Some households will not fight back at all. They will simply stay in bed all day, with as many blankets as they can find piled on.

I am concerned that oil companies have taken advantage of the severe cold weather in December to engage in price gouging. Local oil dealers have not been making a killing from the dramatic increases in the price of home heating oil. Studies reveal that the wholesale price for home heating oil has also skyrocketed and that the average profit for local oil dealers has not changed or has decreased. We are facing a national problem and it demands a national solution. My concern that large oil companies may be using the recent cold weather as an excuse to increase prices is only heightened when I look at the price of crude oil. While home heating oil prices nearly doubled in a month in Maine, the price of crude oil only rose $1.50 a barrel. But the margin of profits realized by Exxon during the month of December rose nearly 300%.

Last year following the Exxon-Valdez tragedy, gasoline prices increased dramatically. A number of State Attorneys General investigated those price increases and found that the large oil companies used the tragic spill as an excuse to simply charge as much as the market could bear - and they all revised their prices at the same time.

Over the years, Maine has had a vigorous antitrust enforcement program. We have brought a number of antitrust cases, and indeed, are currently involved in a multi-billion dollar paper industry antitrust action. It is therefore extreme frustrating to look at the dramatic increases in home heating oil prices and feel that there is little that any state working alone, can do to properly investigate and resolve this matter.

I am very concerned that with the antitrust policies shown by the Department of Justice over the last 10 years, there will not be an adequate investigation of this matter. This policy coupled with frenzied futures trading means our problems could reappear with the next turn in the weather.

When the Department of Justice investigated massive price increases in 1983-1984, they relied exclusively on voluntary testimony of oil company officials and publicly available information. As thousands of Maine citizens struggle each week to pay their home heating bills, they deserve better treatment from their federal government. Although a number of state officials have asked for a vigorous investigation from the Department of Justice or the Department of Energy, to date we have heard nothing. I urge Congress to spur the Department of Justice to do what is necessary and if it will not, to use the congressional investigatory powers to get to the bottom of these exorbitant price increases.

In the meantime, I would request Congress to act immediately to restore the monies that have been cut from federal home heating assistance programs and provide help to people now when they need it most.

T. S. Eliot was wrong. For thousands of Maine people, December was the cruelist month. Thank you.

State of Rhode Island and Providence Plantations
DEPARTMENT OF THE ATTORNEY GENERAL
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(401) 274-4400
James E. O'Neil, *Attorney General*

REMARKS OF RHODE ISLAND ATTORNEY GENERAL
JAMES E. O'NEIL

January 16, 1990

Before

The Senate Committee on Governmental Affairs

Senator Lieberman, members of the Committee, I am pleased to have been given this opporunity to appear before you to discuss the problems which Rhode Island experienced last month with respect to the home heating oil supply shortage and the staggering price increases.

Not since 1904 when the National Weather Service began keeping records on cold temperatures has Rhode Island experienced a colder December month. The average temperature for that month was 21.8 degrees. Prices literally caught consumers in my state by surprise, climbing steadily from an average of 93 cents a gallon to as high as $1.62 per gallon for some consumers. The average high price for the State of Rhode Island was $1.51 per gallon of home heating oil.

When the spiral began, my Consumer Protection Division began gathering information and checking the market, as did all of my colleagues across the country to determine whether there were any illegal or collusive actions contributing to the sudden price spike.

From all indications, it appears that we experienced an extreme example of the supply and demand phenomena. The inventory levels in the New England region, according to information supplied to my department by the wholesale suppliers, were lower at the beginning of November this year than last. As a result, the weekly draw on those inventories doubled through December. For the New England region, we've been told that the increase in demand was roughly 30%, representing an increase from 1 million barrels per day to 1.3 million barrels per day. One manufacturer who met with me and my staff reported that his company sold 9.8 million gallons of home heating oil in Rhode Island during December 1989, representing an increase of nearly 319% over the total number of gallons sold in December 1988.

The increase in demand more directly to our region was 300 to 400,000 barrels a day. ONE HUNDRED, TWENTY-FIVE to ONE HUNDRED, FIFTY THOUSAND (125,000 - 150,000) barrels a day were diverted from home heating oil supplies for residential customers to meet the demand of co-generation plants, which were shut off of their natural gas supplies and had to rely on oil to run their generators. Additionally, I am given to understand that electricity markets impacted the supply of oil when demand required "peaking facilities" to utilize diesel fuel to run their generators in order to continue their operation.

I know that dealers in the Rhode Island area were scrambling to find oil supplies and were aggravated that they were being put on an allocation program where they were not able to get the quantity of supplies that they desired to purchase. I understand also that the wholesalers were, likewise, scrambling for product and that they were forced to purchase on the cash market in order to be able to secure supplies. I was also told that in some circumstances a wholesaler may contract for product, but find later that the entity with whom he contracted simply didn't buy the oil and, therefore, failed to deliver as expected. The wholesaler may have a legal action for breach of contract, but he got no oil.

I can well understand that a variety of factors contributed to the shortage of heating fuels, whether home heating oil, natural gas or propane. All of us who have checked with the area wholesalers serving our markets have probably heard the same stories: that Europe was experiencing equally abnormally cold temperatures and; therefore, that the oil supplies imported across the Atlantic were significantly reduced. We heard that the cold weather in the gulf states caused refineries to shutdown because their pipes froze and they had to make repairs due to the weather damage. There was also the Exxon refinery explosion and fire in Louisiana.
And...transportation of the product was, perhaps, the biggest factor in trying to accommodate the increased demand for oil.

Given all of these various scenarios, it's been said that Murphy's Law is the only law that appropriately can be applied to this situation. However, some nagging questions remain.

We've heard that the free market system worked and that it worked well. While I do feel that the wholesalers and dealers, at least in Rhode Island, responded in a responsible fashion, I would agree that the market "worked" in the sense that higher prices did attract supply which subsequently then brought prices down. Thus, the law of supply and demand worked. But the market certainly did not work on behalf of the consumers.

Oil heat in the winter is the greatest expense for owners of oil-heated homes other than their mortgage. Oil is a necessity for those customers, providing an essential human need: warmth. When the cost of such an essential product spikes more than 50% in a matter of weeks, the market has failed the consumers, and ravaged those on limited incomes who have to divert money for other essentials such as medicine, food, rent or day-care in order to cover the cost of their heating oil.

I have a nagging concern that some of these factors contributing to the oil supply availability could have been foreseen or anticipated in a global sense. We are talking about a world market with respect to the issue of oil supplies. If, in fact, these factors could have been anticipated, my question is why didn't the oil manufacturers have a plan and set about making preparations? One representative of a major oil manufacturer told my staff that several major refineries, including Citgo, Shell, Mobil and Amoco, in Texas and Louisiana ceased operations for a short period all during the same period of time near the holiday season, eliminating an estimated 1.5 million barrels of oil per day from the supply cycle. This raises a question in my mind.

This domino effect may be merely circumstantial and coincidental; but, I would very much like to have some assurances on this matter. I urge the Congress to use every federal resource available to ensure that the circumstances of these oil price increases are investigated thoroughly that the public may be satisfied that no improprieties occurred.

Further, I urge the Congress to explore the problem with transportation which delayed needed supplies of oil getting to the northeast. I'm sure you are all familiar by now with the much discussed "Jones Act." By its own admission, the Federal Maritime Administration prevented foreign-flagged ships from being pressed into emergency service to carry oil supplies between U.S. ports because of the "Jones Act."

I realize that the root of this measure may be planted in concerns over national defense and wanting to promote U.S. shipping interests in general. I also understand that the Federal Maritime Administration has taken the position that there were six U.S. ships available to transport oil owned by Aerochem Corporation of Stamford, Connecticut to New York. In a conversation with Walter Oates of the Federal Maritime Administration on Thursday of last week, he told my office that Aerochem rejected use of the American ships because it would incur having to pay an American crew which was more expensive than a foreign crew. This comment is quite a departure from Aerochem, according to Aerochem's statements in the Wall Street Journal last week. The issue here apparently was whether the ships would be available in time to meet a contractual deadline. According to the article in the Wall Street Journal, the ships would not be available until early February. So, the product was shipped overseas.

My office was also told by the Federal Maritime Administration that three waivers were approved for propane gas because there were no U.S. ships available to accommodate the deliveries. But, these waivers were too little, too late. By the time one waiver was approved, the shipment of propane so badly needed in the northeast was enroute to Italy.

Another waiver granted to move 155,000 barrels of propane from the Bahamas to the East Coast was not granted until the ships had departed to pick up cargoes elsewhere, according to the report in the Wall Street Journal. (Attachment) These are matters of public concern. We really cannot blame private industry for having to get on with its business in order to keep from losing money, but the American public waits at the end of the pipeline and has nowhere to go or turn to recover its loss of funds spent on increased prices for heating oil. It is unconscionable that the United States Government was not more flexible to assist in a timely and very real way millions of American consumers, many of whom live on limited incomes.

George Bush claimed when he sought the presidency that he wanted America to become a "kinder, gentler nation." When consumers were suffering in the northeast, with relief a pen stroke away, where were those virtues? Where was the kindness and gentleness that would have aided the northeast and the rest of the country in meeting its demand for oil product at a more reasonable price to the consumer?

My office has been told by the Federal Maritime Administration that this particular section of the Merchant Marine Act of 1920, the "Jones Act," has been targeted for adjustment in the past and all efforts failed miserably. That may be. I really cannot speak to that, but I do urge this Committee to take it upon itself to revisit the language specific to that section to determine whether there is any feasibility to amending it in order to provide a mechanism capable of being more flexible in times of emergency, such as this past December cold snap.

Another point of concern is the bidding war which took place in the futures market on the New York Merchantile Exchange. In the frenzied trading activity, was there just an opportunity for shrewd investors, and that's all? Or was there an opportunity for shrewd manipulators? I would greatly appreciate reassurances about all of that activity.

These are areas of expertise, which frankly are out of my league; but, as a concerned citizen and as a former Assistant United States Attorney, and now Attorney General, I must admit my curiosity is piqued. Therefore, Senator Lieberman, I respectfully urge this Committee to allow this hearing to be only a beginning of a review process.

In closing, I, again, respectfully urge the Congress to instruct that all available federal resources be used, particularly the Department of Energy and the Justice Department, to examine closely all of the factors contributing to these recent price spikes. A common analogy which we have all heard is that of the orange growers who experience crop damage in a freeze, resulting in an increase in the price of orange juice. Yet, we all know that we can do without orange juice. At the onset of winter with the coldest December on record, heating oil is not something we can do without. It is a necessity.

Yes, we have also heard that it is simply supply and demand. That's the equivalent of saying that fever is just a virus in the body. This argument misses the point. High and volatile prices to consumers, for essential commodities that dominate their home finances, can - like high fevers - themselves be dangerous. It is not enough that the fever broke, we must find out why it got so high in the first place.

Thank you.

(Attachment) January 1990

Maritime Agency Blocked Fuel Shipment That May Have Eased Regional Shortage

By ALLANNA SULLIVAN
Staff Reporter of THE WALL STREET JOURNAL

Despite pleas from industry and government officials, a federal agency was blocking deliveries of fuel oil in recent weeks that might have eased shortages and skyrocketing prices in the Northeast.

Some supplies, lined up in other parts of the country by frantic northern marketers, couldn't be delivered because the U.S. Maritime Administration wouldn't permit them to move on foreign tankers.

A 1920s vintage law designed to promote domestic maritime interests prohibits foreign vessels from carrying cargoes between U.S. ports without waivers. The maritime agency, which often resists waiver requests, continued to do so through the recent severe cold wave even though petroleum pipelines had no free capacity and shippers said U.S. vessels weren't readily available.

As a result, at least six requests that would have released boatloads of badly needed heating oil, propane and residual fuel oil into Northeastern markets at a crucial time were turned down or languished in the federal bureaucracy until delivery became impossible, government and oil industry sources said.

A federal maritime official acknowledged and defended the agency's actions. "The Maritime Administration wants to promote as much business for U.S.-flagged ships and U.S. builders as possible," said Howard Norseth, director of the Office of Domestic Shipping. He said there's no basic U.S. tanker shortage and argued that more imported fuel could have solved some problems. Mr. Norseth also suggested suppliers seeking waivers were simply hoping to make huge profits.

But frustrated U.S. Energy Department officials declared the law, called the Jones Act, "outdated" and "protectionist." They noted that to override it, anyone other than the Secretary of Defense needs approval from several federal offices, including the maritime agency. They argued the law should be amended to allow for consumer as well as defense emergencies. As it stands, they said, only 150 waivers have been granted in more than 35 years.

Industry and federal officials maintained that if spot, or noncontract, oil had been delivered to the Northeast in available foreign ships during the recent freeze, fuel prices might not have surged to such dizzying heights there. "Occasional shipments when the pipelines are full could help alleviate spot shortages," said Arlen Erdahl, who oversees energy emergencies for the Energy Department.

Instead, some terminals ran out of fuel oil and some dealers were allocating it and propane. Wholesale heating oil prices jumped by more than 25 cents a gallon in 10 days. In Massachusetts, they have soared by more than 60 cents a gallon since October, and aren't expected to recede soon, the state reported. "This is a serious problem – particularly for those with low and fixed incomes," said Paul Gromer, state energy resources commissioner.

Rising temperatures have rescued the Northeast for now. But federal and state energy officials, shaken by how vulnerable the area proved to be, remain worried. "We're having a respite now, but we're not out of the woods yet," said Mr. Erdahl. "It's just the beginning of winter."

Last Thursday, the Energy Department asked the Interstate Commerce Commission to figure out how to expedite heating oil and propane shipments to the Northeast, where inventories are described as "dangerously low."

Federal energy, defense, maritime and customs officials are also planning meetings in hopes of assuring fuel supplies aren't again blocked from needy markets. The U.S. Customs Service, part of the Treasury Department, administers Jones Act waiver requests, based on recommendations by the Maritime Administration and other agencies involved with each particular matter.

But maritime officials are expected to remain tough. When reminded that there's only one U.S. vessel capable of hauling propane and that that vessel is now headed for Korea, Mr. Norseth of the agency had a ready response. Extra propane for peak demand periods in the Northeast could be imported, he suggested, adding that much of the propane used there already is imported.

Maritime officials also alleged that some refiners request waivers to avoid using more costly U.S. flagships. And they contended suppliers really want to line their pockets by selling in more lucrative markets rather than alleviate energy shortages.

Such allegations reflect "unmitigated gall," said Mike Muckleroy, president of Enron Corp.'s liquid fuels division, which recently was denied a waiver after making its first such request in more than five years. Mr. Muckleroy said that on Dec. 21, he told the customs agency that Enron was loading two million gallons of propane in Houston into a Spanish ship destined for Italy. He said he advised the government the cargo could be diverted to the Northeast if he got a waiver within three and a half days.

Two days later, he said, others interceded on Enron's behalf at a special meeting of federal officials. The governor of Vermont sent a telegram to the Energy Secretary asking him to urge the Treasury Secretary to grant a shipping waiver. "We had hundreds of calls from up there begging for that fuel," Mr. Muckleroy said. "I even had a call from a utility on Christmas day."

But more than seven days passed before Enron got any response, he said, and by then the ship was too far into the Atlantic Ocean to be turned around.

"So the propane went to Rome where it was 65 degrees," Mr. Muckleroy said. "The system just doesn't work."

The Maritime Administration did grant a waiver late last month for 155,000 barrels of propane to move from the Bahamas to the East Coast on two foreign vessels. But it took five or six days to complete the waiver, one person familiar with the transaction said. By then, the ships had left port to pick up cargoes [illegible] can cost its owner $30,000 a day.

A major point of contention is whether U.S. ships are available. During the height of the cold snap, Aerochem Corp. of Stamford, Conn., asked for a waiver to move a cargo of residual fuel to New York by a contractual due date of Jan. 15. U.S. vessels were unavailable during that time frame, it said. The request was denied. Aerochem was told that there were enough U.S. ships to move its cargo, although none were available until early February.

"In general, there's no shortage of tankers," Mr. Norseth concluded. "Whether their availability coincides with schedules or business arrangements is not germane." Aerochem's fuel finally went overseas.

CITIZENS
ENERGY
CORPORATION
a non-profit energy company

TESTIMONY OF MICHAEL LEM. KENNEDY,
CHAIRMAN, CITIZENS ENERGY CORPORATION

Thank you Mr. Chairman for the opportunity to be here with you and the members of the Governmental Affairs Committee.

I'm here today as Chairman of Citizens Energy Corporation to discuss recent fluctuations in the oil market. Our work at Citizens, an organization which is both an advocate for the poor and a member of the energy industry, has allowed us a unique perspective on the current situation.

Citizens Energy is a non-profit energy company which was founded ten years ago by my brother, Congressman Joe Kennedy, to provide low-cost heating oil to poor and elderly families. For nine winters, Citizens worked with the Massachusetts Fuel Assistance Program, providing heating oil to the program at 30 to 40% below market prices. We continue to provide information and advocacy to thousands of needy families across Massachusetts who cannot meet their energy needs.

Since our original bulk oil program, the Citizens family of companies has grown to include for-profit, taxable subsidiaries with activities in oil exploration and production, crude oil trading, retail oil distribution, and natural gas and electric power marketing. Citizens Energy has created assistance funds in seven states to help

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low-income customers of gas and electric utilities who purchase energy from a Citizens company. This is our third year of working with the retail heating oil industry in Massachusetts to provide free oil to 36 homeless shelters across the state. Local dealers deliver oil to the shelters and bill Citizens at the wholesale price, foregoing their profits to help the homeless. Over the past ten years, Citizens Energy has generated over $22 million in funds to help needy families across the United States.

Review of December Market

Citizens and its subsidiaries are recognized participants in the energy industry. That fact and our activities on behalf of the poor combine to make our experience in last month's market rather unique. This is the way we saw it:

By this point in your hearings, you have heard all of the fundamental factors impacting on December's price spike. Last month, as we all know, was the coldest December on record. Cold spells in the South caused freeze-ups at oil refineries and natural gas well-heads. Near-zero temperatures spiked demand in the South and kept natural gas within intrastate markets in Louisiana, Texas and Oklahoma. Interruptible gas transportation space was virtually non-existent which dramatically curtailed natural gas availability to the Northeast.

Low water levels in Europe, particularly along the Rhine River, and in Canada affected energy supplies here in the U.S. Increased European demand pulled some cargoes away from the American market while low water levels in Canada put a strain on that country's hydroelectric production, forcing the Canadians to come into the American market to buy supplemental power. Many electric utilities in the Northeast had to switch to #2 oil as a fuel source due to peak power demands and low natural gas availability. This factor put an added burden onto an already strained oil supply system. As an example, while the focus of the media has been on heating oil prices, low-sulfur fuel oil, which is normally the type of oil burned by electric utilities and other large industrial users, reacted to the prevailing conditions in a similar manner. During December, cargo prices for heating oil rose more than 50% while residual cargoes increased by more than 70%. However, since #6 oil is not primarily a consumer-related fuel, it does not draw the public attention that heating oil does. The overall result of these events: Supply problems and higher prices in the oil industry, the natural gas industry and the electric power industry.

Those seeking explanations of last month's price spikes should not confine their search to events taking place in December. The heating oil market has been relatively stable over the past year. Weather forecasts last year called for another mild winter. For a variety of reasons, oil inventories were maintained at lower levels. According to the Energy Information Administration, the onset of extremely cold weather produced a 33% increase in demand over 1988 levels that could not be met by normal supply sources.

MERC Influence

If you are trying to understand why prices climbed so dramatically last month, you must first understand the reality of how oil prices are set. The international oil market is an extremely large one and is comprised of many different participants. It's not possible for the industry to be "controlled" by a few oil companies. Second, the New York Mercantile Exchange, or the MERC for short, establishes the pricing basis for the physical cargoes of oil. Trading oil on the commodity market, while providing a hedge for the buyers and sellers, also tends to create volatility as well as accelerate and magnify price trends. Prices would have been high without the MERC, for the reasons I've already explained, but the commodity market effect added to the price run-up.

How much did it add? Because of the many and varied complexities associated with the MERC, this is difficult to quantify. However, the price run-up from $.68 on the MERC (which translates roughly into $1.00 retail) in mid-December to $1.00 on the MERC by the end of the month was due in part to highly speculative trading in the January #2 oil contract. It is interesting to note that when the January contract expired on December 29 at $.965 per gallon, the February contract was trading at $.7525 per gallon. For the first five trading days after the January contract expired, the February contract, which was not under similar speculative pressures, fell by over $.10 per gallon. Price fluctuations such as these are inherent in this kind of system and will continue to be so for the foreseeable future. The primary point of interest for this committee should be the potential for dramatic price increases in energy products created by a commodity market. It cannot be a pleasant thought for consumers to contemplate what effect this type of market would have on energy prices in a real crisis situation.

It is possible that heating oil and other consumer-related energy products which are basic necessities should not be traded like corn futures and pork bellies. I think that we've seen from past experience that unregulated energy industries are generally more effective at meeting consumer needs over the long-term than are regulated energy businesses. Unpredictable occurrances like December's cold weather should not prompt us to abandon sound business practice and good public policy and we should not revert back to the energy regulations of the 1970s. However, it may be prudent to review the desirability of an energy market free-for-all environment created by the MERC that encourages speculation and does little to add intrinsic value to our society.

Consumer Assistance

Price spikes like the one we saw last month affect everyone from homeowners to owners of industry, but the folks who are hardest hit are those citizens living on low and fixed incomes. We at Citizens hear from poor people with energy problems every year, but this winter has been particularly hard.

Let me give you an idea of the kind of people we work with at Citizens Energy. Recently, our office received a call from a nurse at Boston City Hospital concerning a young mother living in Revere who had no oil to heat her home. This woman has two small children, under the age of five, and had been homeless until May of last year. The nurse knew of the woman because the youngest child, who is one-and-a-half years old, has a serious respiratory condition which requires frequent hospital visits. It was only the end of December and this young woman had already exhausted her fuel assistance benefits for the entire winter. Citizens was able to assist in obtaining 125 gallons of oil for this woman and her family, but what will she do when that runs out? There are so many families, so many elderly people, who are not going to make it through the winter on their fuel assistance benefits. The state program in Massachusetts has more than 10,000 new applications above levels set last year at this time. Elderly citizens in Massachusetts on Social Security are forced to live on only $483 per month. Almost 22% of their yearly income is spent on energy alone. That percentage skyrockets in the winter months. At $1.30 per gallon, an elderly person living on Social Security would have had to pay $325 for a 250-gallon tankful of oil. That's 66% of an elderly person's income spent on oil alone. Price spikes in the cost of oil rapidly eat up already limited funds. What can be done to assist these programs and protect this most vulnerable sector of our society from the ups and downs of the market?

Recommendations

Unfortunately, there are no quick and easy solutions to the fluctuations we experienced last month. Price spikes will occur in a free market system unencumbered by government regulation. On a very basic level, encouraging all heating oil consumers to be smart shoppers is the simplest response to the problem. If consumers would use the opportunity available to them in a free market to buy oil from the dealer with both the best price and the best service, they could stimulate competition and possibly get a better deal.

In addition, energy conservation, while not a new idea, is still the best way to reduce our dependence on foreign oil and our susceptibility to drastic price increases. Emphasis on the benefits of energy conservation and incentives for its implementation are critical to a strong and responsible national energy policy.

Next, let me state that the cuts in LIHEAP (Low Income Home Energy Assistance Program) funding proposed by the Bush Administration are totally inappropriate. In Massachusetts, federal cuts have already forced the state to lower benefit levels and shorten the program year. LIHEAP funding should be increased, not decreased, and rules governing the administration of the program should be rewritten to give state agencies more flexibility in the spending of the funds.

Improvements in the system are possible which could benefit the poor and elderly in our society. This is a commodity-oriented, market-driven situation. Poor people, many of whom receive some form of energy assistance from state and federal fuel assistance programs, are at the mercy of the market. So why not use the market to their advantage? State agencies and similar groups who pay for energy for needy families should use their substantial buying power to get the best deal for their money.

In the Commonwealth of Massachusetts, for example, the state fuel assistance program last winter bought more that 23 million gallons of oil for more than 45,000 low-income households. At about 90 cents per gallon, that's more than 16 million dollars spent within the oil industry on behalf of the poor and elderly. Administrators of fuel assistance programs should be allowed to use the tools provided by the market to protect themselves from drastic price increases. For instance, by securing options to buy heating oil and locking into set prices before the winter and the threat of bad weather overtake the market, fuel assistance providers could better budget their limited dollars. By using the market, state programs could save money, money that would be better used to increase benefit levels and serve more families. Waiting for the heating season to purchase requirements of heating oil is the riskiest of all possible positions as it leaves those groups totally at the mercy of the market.

Another important fact highlighted by the December situation is that our overall energy system is strained to a point that can accommodate only very minor disruptions. This situation, particularly in the Northeast, is likely to worsen in the coming years. Our existing energy policy may be too bureaucratic in its approach and administration to adequately deal with this problem in time to avert even more potentially serious future situations. We must promptly move to provide the means for increasing natural gas availability to the Northeast as well as examine the possibility of regional oil storage (which may have as many disadvantages as potential advantages). The fact is that the Northeast will need all of the energy sources available in the coming decade to meet its needs and prevent serious shortages and price increases.

In closing, let me say that the recent price spikes were unfortunate. The energy industry works well in general, but aberrations like last month's weather cannot be planned for. What can and must be planned for are the inherent price fluctuations and their impact on those unwitting and most vulnerable players in the energy industry: the poor and the elderly.

TESTIMONY OF LAWRENCE KELLY, EXECUTIVE DIRECTOR
TRI-COUNTY COMMUNITY ACTION PROGRAMS, INC.
TO THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

January 16, 1990

Mr. Chairman, my name is Lawrence Kelly. I am the Executive Director of the Tri-County Community Action Agency. I am here on behalf of the National Community Action Foundation to address the problems which plummeting temperatures, skyrocketing oil prices and the long-term decline in LIHEAP resources are presenting to the people we serve.

Tri-County CAP serves the northern half of New Hampshire. This area, often referred to as "the North Country" differs significantly from New Hampshire's southern tier. My office is in Berlin, a milltown of 13,000 and the largest town in our three counties. Our population of 170,000 is scattered along narrow, twisting roads without public transportation. There are two large paper mills, tourist sites and some light industry, but the large-scale development which has characterized the last decade to the south has not penetrated the mountain notches. Much of the economy is seasonal and there are severe pockets of isolated rural poverty.

Mr. Chairman, the Energy Assistance program is no longer the powerful bulwark against the winter cold that it was in the prior record cold winter of 1983-84. That year, the program was appropriated, first $1.875 billion and then $200 million more in a supplemental because the weather was extreme. I am submitting to you a graph (Figure I) that uses the Department of Health and Human Services' own figures to show the trends in home energy bills of the poor compared to funding in the 1980's.

Today, the program has been slashed by 32% to $1.393 billion, or a drop of over 45% in real dollars. Energy costs, even before the December crisis were not lower. According to HHS, the poor spent 1% more on energy than in 1986 in 1989. Other resources have not become available as promised.

From its FY 1986 level of $2.1 billion, the program has lost $1.91 billion if the cuts over 4 fiscal years are totalled to show the amounts not available to pay energy bills. Up to $34 million is raised by utilities in some states to make donations to utlity clients. The oil overcharge funds allocated to the program over not only those four years, but all future ones come to $660 million. In other words, the cuts were about three times as large as the replacement resources available.

The average LIHEP recipient still has a family income of under $7,000 a year and in normal years, spends just over 13% of it on home energy. Another graph (Figure 2) I have submitted for your Record, shows that these households have less than $457 a year left to spend on clothing, transportation, medical care, school supplies and all other needs after paying for food, housing and energy. This clearly dramatizes how significant assistance payments are in their lives.

A recent National Consumer Law Center Report, which I am also submitting for your Record, shows that a widow on an average Social Security pension benefit in New Hampshire will have only $74 left each week in winter after paying her oil bills (in a normal winter). This must cover housing, food, transportation, telephone and everything else. The comparable figure in Connecticut is $86; in Michigan it is $85; in Tennessee it is $71; and in Maine it is as low as $66. Bulk fuel users spend over 16% on energy. However, over 900,000 households or over 2 million fewer individuals are receiving benefits compared to FY 1986. The FY 1989 program has an estimated 5.9 million participants compared to 6.8 million in 1986. Nearly 19 million households are eligible. Further, the average benefit has dropped over 13% in that period of time while energy prices have not.

In this context, the events of this past month are a major threat to our low income clients; those who, as in our area, depend on bulk fuels, feel it most acutely. We are experiencing a major crisis for the poor at present, with no hope of meeting the need. The data we have provided the subcommittee is average data for a normal year. This is not a normal year and the pressures on the poor are dramatic.

This year in Northern New Hampshire, December 1989 had 2,715 heating degree days - 56% higher than last December, and 22% higher than average. Compounding the greater need for fuel, we saw the price of oil go to a cash price of $1.449/gallon, up from $ .819/gallon last year. A 275-gallon tank of oil currently costs $398. The average client's Fuel Assistance benefit is $410, or roughly one tank of oil. Last year, the average benefit was $450. A client could get 550 gallons of oil, or two tanks for their FAP benefit. The average household used more than one full tank of oil just in this past December. Last year, the same household could go through all of December and most of January.

The number of clients applying for assistance is 20% greater than last year.

The poor, handicapped, sick and elderly citizens whom we serve are caught in a crossfire. The problems caused by the cut in Fuel Assistance funding since 1985 (Tri-County help has declined from 5,937 households @ $495 to 4,453 @ $406) have been coupled to the increasing cost of fuel oil, linked to an increasing need per household caused by sub-zero weather, and joined with increasing overall demand to grow to crisis proportions. This is a crisis with which we cannot cope.

What are the practical effects of this situation on people in the North Country?

Freeze Ups Families are being forced out of their homes as heating and plumbing systems seize up due to cold. On the Christmas weekend, I was called personally by a family in Whitefield (referred by the Town) whose rental house was rendered unfit for living by a freeze-up. The landlord couldn't or wouldn't effect repairs. We arranged for temporary shelter and the family with small children spent Christmas in a Littleton motel.

Evictions Low-income renters rely on Fuel Assistance to meet rental obligations. The delay in the funding necessary to start the program this year caused tension, apprehension and some evictions. The worsening situation has and will result in more.

Borrowing Low-income and elderly with minimal fixed incomes are having to borrow to heat their homes. LIHEAP which has covered 40 to 50% of their fuel bills will only reach about 25%. There is little or no credit extended to these customers by local fuel companies.

Suffering High risk elderly are turning down thermostats to 62° - 45° on permanent basis

Families and individuals are skipping meals to make fuel delivery payments

Phones, in insolated homes where sickness or chronic conditions or elderly frailty make them essential to health, are being disconnected to make fuel money available

People with low incomes and no credit are purchasing fuel in 5-gallon cans. Unable to scrape together money for more than a few gallons, and unable to obtain delivery for this small amount, they must find a way to transport their containers to the oil dealer, often from remote locations, and return. Back home, while the fuel burns, the wheel turns again and they must look for payment for the next purchase.

With central heating down, households are resorting to dangerous and inefficient substitutes such as space heaters, and kitchen stoves.

Homes are going unheated. Sometimes, while people are looking for help, or trying to arrange or waiting for deliveries, or are discouraged or confused, homes are without heat. Blankets become the last defense.

Tri-County and the other New Hampshire CAP's have reacted to the program cuts by reducing permanent and temporary staff and by cutting back on the number of Outreach and Outreach certification centers (in Tri-County's case, Fuel Central staff reduced from 10 to 4, Outreach from 18 to 11; sites from 18 full-time sites and 2 part-time sites to 11 full-time sites and some occasional meeting places). Home visits have been drastically curtailed.

Outeach is essential to an effective program. In addition to the obvious necessity of bringing the program within reach of people in isolated situations, many who are eligible need personal contact, assistance in understanding the program, completing the forms, or just help in coming to terms with their situation. Our staff has, in the past, been very effective in providing this help and in connecting those in need to other sources, our own or other agencies, where such help is necessary. Reductions, cuts and increased workloads have made this very hard to do. They have made the system more vulnerable to the kind of crisis we are currently experiencing. Our staff is under considerable strain, facing emergency calls, crowded offices, an avalanche of need without resources adequate to meet it.

We have sought additional support wherever possible. All 72 towns in the three county-area provide some support to the program. But as they never tire of telling us with considerable truth, they are strained to the limit. We have obtained $12,000 in food, $12,000 in shelter and $8,700 in loan funding through the State of New Hampshire. FEMA funds are used to exhaustion. Our staff continually raises small emergency donations from local churches, organizations and even from individuals. These fund raising efforts tend to be time-consuming, unreliable and inadequate to the level of need.

Our major utility is in bankruptcy and has largely fumbled away its consumer responsibilities. Several years ago, New Hampshire Community Action agencies met with Public Service of New Hampshire and developed a plan involving counseling, direct relief and low-income accomodations. The plan was successfully tested in part, but wholly abandoned as P.S.N.H. lurched into controversial bankruptcy. Only a small, ineffective, and unreliable program remains, financed by voluntary consumer contributions.

The vaunted Oil Overcharge rebate is declining nationally and has never proved to be much of a resource to New Hampshire LIHEAP even in its heyday. A total of $750,000 has been earmarked to LIHEAP in this state over the life of the program. Without your help, I do not think we can develop the necessary resources. Unless we can provide help, people with no alternative will turn to costly, imprudent and dangerous measures to meet their inescapable needs.

TESTIMONY OF LAWRENCE KELLY, EXECUTIVE DIRECTOR
TRI-COUNTY COMMUNITY ACTION PROGRAMS, INC.

Mr. Chairman, at this point, I would like to share some recent examples of the impact which the current crisis has had on human lives in an area dependent on fuel oil. I believe they can speak more directly and forcefully to this issue than I can:

1) Verteran, 40, single, almost froze to death when he ran out of fuel in mobile home. All pipes in plumbing and heating system froze. He ran out of LIHEAP benefits. He asked neighbor if he could live in his cellar for the remainder of winter in order to survive.

2) Single parent Mom, mid 30's, with children, two and four year old, trying to stretch LIHEAP $ is making daily walks in the woods with children to gather down and dead wood in adjacent forest to help meet expenses.

3) Hispanic family with four children have had to go next door to neighbors, to cook their food because they can't buy propane for their stove.

4) Battered woman, with two children, was beaten and abandoned by husband. They recently moved here from Texas. No local friends or relatives. Woman and two children living in an apartment without electricity.

5) Single lady, mid 50's, partially disabled and is currently enrolled in Voc-Rehab program, ran out of LIHEAP benefits and no other resources. Was trying to provide heat for herself and trailer by sitting in front of stove with oven on. Result, pipes froze and she had to be treated for hypothermia.

6) Elderly man, 79, lives alone in shack, has brain cancer, under $300/month income. May not survive winter without additional LIHEAP help.

7) Single parent Mom, early 30's, recently had her 1½ year old child removed from her home by State Welfare because she couldn't provide adequate heat and electricity for child.

8) Single man, 36, was injured in a pedestrian/auto accident six months ago and is awaiting settlement. Without additional LIHEAP funds he will be evicted.

9) Elderly woman, 78, lives alone because husband and his social security check were recently moved to a nursing home. She's exhausted LIHEAP benefits and has inadequate SS resources with one check to maintain home heat.

10) 90-year old lady, has exhausted her LIHEAP benefits and resources last week. Our Outreach staff intervened and provided an anonymous donation in order for her to get another delivery. Through trust established by personal contact with her CAP Outreach worker, she was willing to participate in LIHEAP, but was "too proud" and refused to ask for any type of "public assistance".

11) An oil deliveryman, discovering that one of our clients was using her food money to pay for C.O.D. oil delivery, called our Outreach Center for help.

12) Couple, in their early thirties, wife is pregnant with twins, husband is self-employed. They have exhausted their LIHEAP benefits and no other resources.

13) Elderly lady, 90, lives alone, no indoor plumbing, only heat is wood. Without additional LIHEAP funds she will be without heat.

14) Single working parent has exhausted LIHEAP benefits. Family was without electricity for 48 hours until we found them some local funds. No electricity - no furnace.

15) 84-year old lady, living alone, had to go to the bank last week and borrow funds in order to get a fuel delivery. She's living on minimum Social Security payment of $354/month.

16) Single young man, can only find part-time work. Surviving by living in a van inside a garage heated with a contractor's protable space heater.

17) Single female parent recently lost job, exhausted LIHEAP benefits, has 15-year old daughter. They are facing an eviction without additional help.

18) Single female, with mental problems, can't cope and can't pay bills -- facing an eviction without additional LIHEAP $.

19) Family of 7, with disabled husband, only receiving partial disability payments. Just lost their telephone and exhausted their LIHEAP benefits and no funds.

20) Young male teenager, school drop-out, was living in an old trailer, ran out of LIHEAP benefits, out of fuel, pipes froze, lost all his food and housing.

21) Man in his mid 50's, lost his job this fall, worked all his life, never received any public assistance. Has looked for work in a 60-mile radius of his home. Running out of LIHEAP benefits, won't make it through winter without additional help.

These problems could best be met through a program combining adequately funded LIHEAP, Weatherization and Rural Home Repair Programs. These programs can be effectively administered in concert: with Home Repair supplementing Weatherization and their combined effect focussed precisely on the LIHEAP eligible population, reducing their energy costs.

Tri-County CAP presently operates each of these programs in an anemic form. You are studying the problems presently besetting LIHEAP. Our Weatherization backlogs are currently so long that we are reluctant to inform eligible participants about the program. A State Weatherization Directors' Association survey warns of a 26% '87-89 program reduction to reach 43% by 1991 (N.H. figures 88-91: -16%, -34%, -54%, -65%). We participate in a national HHS Rural Home Repair grant which is small ($60,000 last year, all expended) and intermittent. You can see how difficult it is under the present circumstances to combine these programs into the effective, concentric weapon they could be; and to turn that weapon against the energy problems facing the poor and the nation.

It is frustrating to spend the $1,600 limit in incompletely weatherizing a home, watch the household spend down their LIHEAP allotment and know that expensive energy is poring through the cracks. It is frustrating to see a family pour its LIHEAP benefits into a jury-rigged heating system in a windblown house and only be able to offer a lengthening waiting list. It is frustrating to know that existing programs could make all the difference, but that right now, they won't. We urge your support of LIHEAP, Weatherization and Rural Home Repair at a 1991 level that will make this difference possible.

At the moment, however, let me assure you that we badly need and can quickly utilize a $300 million 1990 LIHEAP supplemental appropriation. This is the minimum needed to increase payments to bulk fuel householdsby about 50%

and to provide an average benefit level to the 900,000 households dropped from the program in the last 2 years; many of whom are already reapplying for assistance in their current desperate situation.

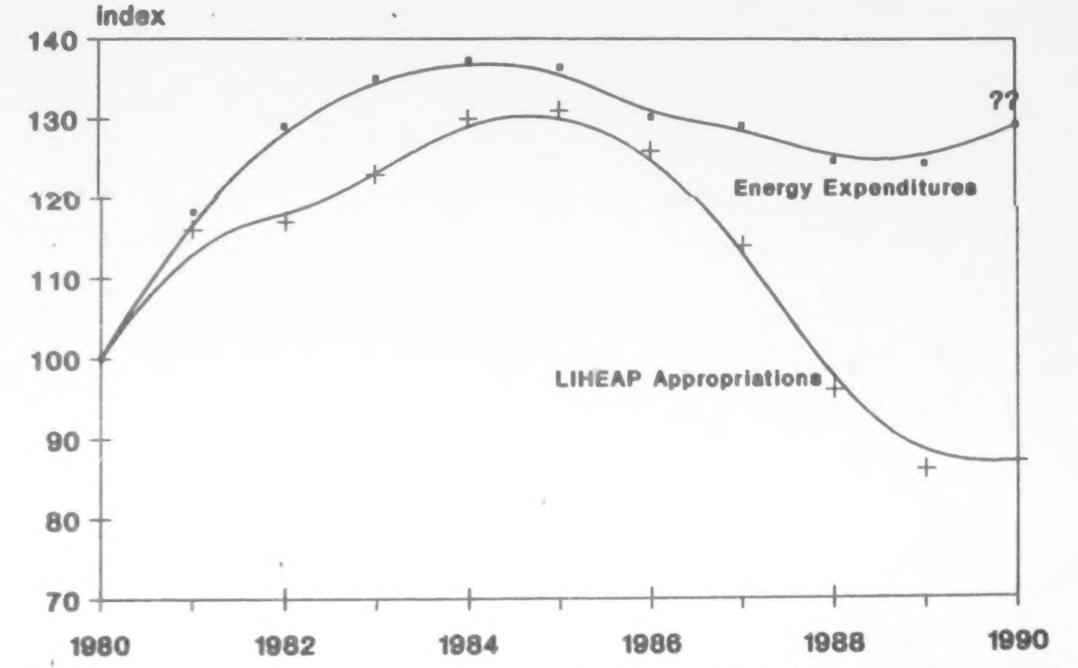
However, this assistance is still going to mean that only 42% of an average winter's fuel costs on a national average will be met, and in New Hampshire, far less of the bill will be covered, leaving families with large remaining obligations. Whether this winter will continue its record-breaking course cannot yet be predicted, but it is certain that many will go cold.

The real solution is a program that meets the need, weatherizes the houses permanently, and does not lurch from crisis to crisis. The program should meet the same proportion of need it did in 1986. Matching the aggregate real cost of home energy for the poor, the FY 1990 program should have been at least $2.5 billion, not $1.4 billion. We urge you to support reauthorization and appropriations at $2.5 billion for FY 1991. This policy goes hand in hand with investigatory initiatives and energy market strategies your other witnesses have explored today.

I deeply appreciate the consideration which you are giving to these problems and conditions and assure you that it is appreciated by all of those in New Hampshire who have sought our assistance or expressed their concern. We are depending on your compassion, your leadership and your capacity.

Fig. 1

Home Energy Costs for the Poor
and LIHEAP Appropriations:1980-90



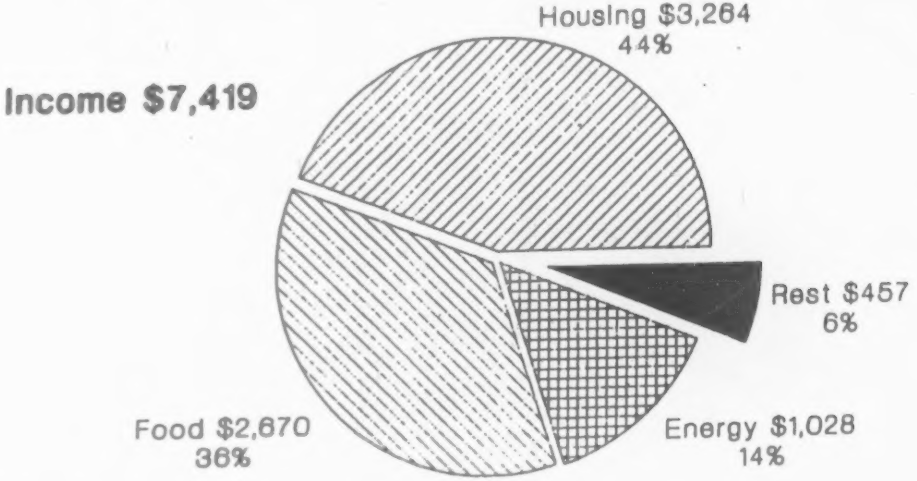
source:USDHHS Testimony 4/89

National Community Action Foundation

Fig. 2

What's Left of Low-Income Budgets After Housing, Food and Energy Costs

Households Under 125% of Poverty, 1989



Source: Census Bureau Survey Tapes, updated by Consumer Price Index

Prepared by The Grier Partnership

Statement of Senator Donald W. Riegle, Jr.

Mr. Chairman:

Thank you for allowing me the opportunity to discuss the impact the recent increase in fuel prices have on consumers in Michigan.

Michigan, like much of the Northeast and Midwest, suffered through brutal cold in December. In the Northern part of the state temperatures averaged around 10 degrees for the month. It is understandable that more heating fuels would be used in this situation. However, the magnitude of the price increases accompanying this crisis created an alarming situation for many of my constituents. For those on fixed incomes and the unemployed, the price increases represent more than an inconvenience. In one case, a constituent contacted my office expressing concern over the huge increase in the price of propane. This constituent was told that until his balance of $332 was paid in full, no more propane would be delivered to heat his home and operate other basic household appliances. This gas customer estimates that he has a 60-90 day supply of propane left to get through the coldest winter months. However, in the upper peninsula of Michigan where this man lives, very cold temperatures can last far into the spring.

While we all understand the importance of paying our bills, it is important to note that this constituent was prepared to pay in full, even in the event of a cold winter, except he did not anticipate a doubling in the price of propane gas. It is difficult for me to believe that anyone could plan for a doubling of fuel prices in a year of unprecedented need. This is especially distressing to my constituents in the Upper Peninsula. While some price competition may exist in places where numerous energy sources are available, many of my constituents do not have that choice. Because most people in the northern part of Michigan do not have access to natural gas, their heating sources are limited to fuel oil, propane gas or wood. When the price of propane doubles and the cost of #2 grade fuel oil increases by 15-20% over the previous year, it is easy to see how many people, especially those on fixed incomes, can be caught off guard.

The constituent cited above is but one example of a fuel consumer not negligent in his responsibility, but unprepared for such a dramatic increase in price and personal consumption. The question then becomes how could this happen? While the oil companies now explain this crunch in terms of supply and demand, why were customers in the dark about a possible problem in supply in the event of a cold winter? In the case of propane, one gas company explains that increases in the use of the gas to dry crops and the fact that marketers anticipating a shortage filled storage facilities to higher levels, contributed to the price increase. While I am sure customers appreciate this information, it appears that some companies were aware of impending upward price pressures well in advance of the announced increases.

Surely, a doubling of the price of propane was not preceded by "normal" market conditions.

We can never know for certain whether the price increases in practically all fuels is in line with market forces creating upward pressure on prices. Still, many of my constituents have expressed concern over the possibility that they are being gouged by companies taking advantage of record cold in many parts of the country. Clearly, the use of all heating fuels reached unprecedented levels during this cold period and supplies were stressed. I do not believe anyone wants to see an industry forced to operate in an unwise financial manner. However, we must make certain that those companies involved in providing services essential to the well being of our constituents, operate in a manner that does not place many in the at-risk population in dangerous and potentially fatal circumstances.

Hopefully, this hearing will bring some light to this important issue. Those most profoundly affected by these kinds of price increases are the unemployed, Seniors citizens and others on fixed incomes. These are in many cases those most vulnerable to the dangers of winter cold. It is important that we thoroughly investigate the causes of these serious price increases and ways to avoid wild price fluctuations in the future.

STATE OF MAINE
OFFICE OF THE GOVERNOR
AUGUSTA, MAINE
04333

JOHN R. MCKERNAN, JR.
GOVERNOR

January 11, 1990

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
United States Senate
Washington, DC 20510

Dear Senator Glenn:

This letter and its attachments are being forwarded to you for next week's hearing on the recent rise in home heating oil prices. As Governor of a state that has been severely affected by this price rise, I would respectfully ask that my comments be placed in the record for the Committee's consideration.

As you are no doubt aware, the December price increase in heating oil prices has had a profound impact on the State of Maine. Approximately 65 percent of Maine's households use oil as a primary source of heat. Many of these households are simply not able to absorb such a price shock.

In response, I have taken two immediate steps to help us understand and mitigate the effects of these record prices. First, I have established a Gubernatorial Task Force to analyze the issue, and second, I have proposed state legislation that would allocate an additional $1.7 million in available funding for this year's heating assistance programs.

Neither of these steps do, however, fully remedy what has been a very critical situation, and several very significant questions remain. While Maine experienced a December that was approximately 25 percent colder than normal, this fact alone cannot account for an almost 70 percent jump in the price of home heating oil. On behalf of the citizens of Maine, I strongly urge you to investigate thoroughly this staggering price increase. Anything less than a complete investigation will be a disservice to the nation's consumers and will leave us unduly vulnerable to future energy shocks.

To aid in the Committee's review, I have attached a summary of the ongoing efforts of my heating oil price Task Force. You can see in Exhibit 1 that, over this year's heating season, retail prices have closely followed rising wholesale prices. Exhibit 2 shows that retail prices over the last three years have also closely mirrored changes in wholesale costs. Exhibits 3 and 4 indicate that retail dealer mark-ups follow fairly constant seasonal trends, and that mark-ups remained level and were actually squeezed during late December as the retail sector scrambled to keep up with a chaotic wholesale market. The problem, therefore, lies well beyond the borders of Maine.

The Task Force has also looked at weather and regional inventory data to determine possible cases for this event. Exhibit 5 demonstrates what we already know: That December was a record cold month for Maine with temperatures approaching 25 percent colder than normal. Again, however, a 25 percent increase in the severity of the weather, assuming a more or less 25 percent increase in regional demand, cannot explain a 70 percent price increase.

Exhibit 6 is more interesting. In looking at New England regional inventories going into the 1989-90 heating season, we find that stocks were 24 percent less than prior year levels, indicating that the industry was unprepared for a colder than normal month. This exhibit also demonstrates the significant draw-down that occurred throughout December. Wholesalers were clearly unable to replenish their supplies, resulting in inventory reductions to 50 percent of prior year levels by December 29. However, it should be noted that this is an aggregate number. In fact, spot shortages or "run-outs" occurred on an almost daily basis among the various Portland terminals.

The questions raised by these data are obvious. Why were inventories so low going into the 1989-90 heating season? Was it simply complacency based on moderate weather forecasts, as some have said, or is it indicative of another matter? Why was the industry apparently unable to react adequately to the increased December demand? While oil industry representatives have blamed curtailed refinery production as a contributing factor, our investigation indicates that production of #2 fuel oil was actually 3-5 percent greater than prior year levels up until the very end of December, at which time weather and accidents did, in fact, have an impact. Although this may slow the industry's recovery (and even this is unlikely due to the recent warming trend) it is not coincident with the early December price fly-up and cannot, therefore, be viewed as a contributing factor.

An additional issue requiring scrutiny is the degree to which transportation bottlenecks exacerbated a tightening regional supply situation. In particularly, I would urge the Committee to look very closely at the reported rejection of applications for Jones Act waivers that could have brought significant supplies of heating oil and much needed propane into New England when it was most needed. According to the January 8 Wall Street Journal, the Federal Maritime Administration believes that, although there was a general availability of U.S. flagged tankers during this period, the fact that the tankers were unavailable to meet New England's pressing need was said to be "not germane" to assessing the issuance of a waiver. I am concerned that, at a time when Maine and New England were experiencing an energy emergency, the Maritime Agency pursued a policy that contributed to the imposition of unconscionable costs on the citizens of New England.

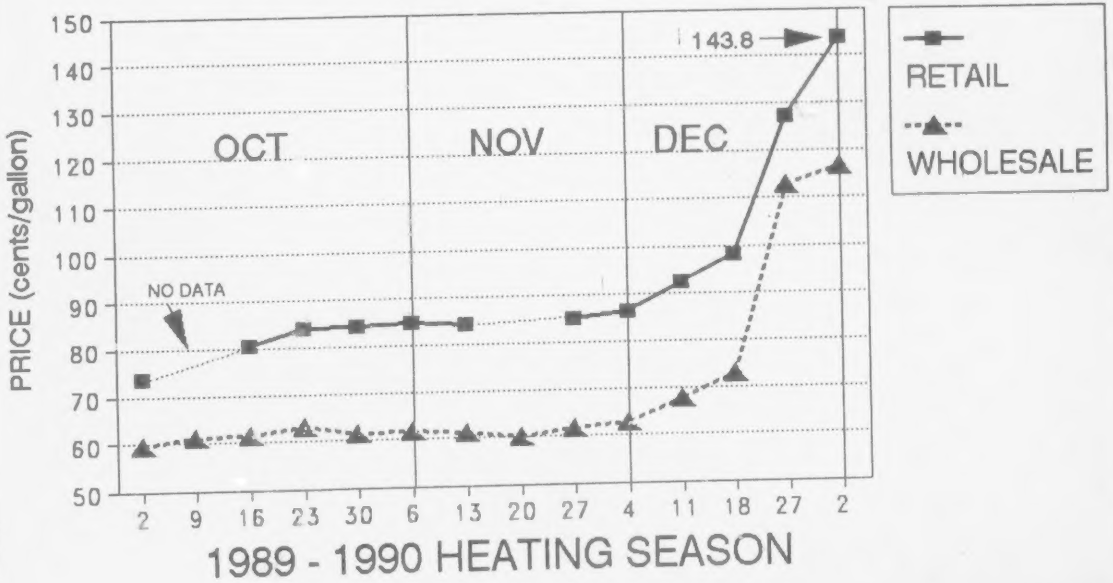
While the State of Maine will continue to pursue its investigation, it is our view that many of the issues raised by this highly unusual event are more appropriately the subject of federal review. Nonetheless, I appreciate this opportunity to work with the Committee and pledge our continued support.

Sincerely,

John R. McKernan, Jr.
Governor

JRM/lab

Enclosure

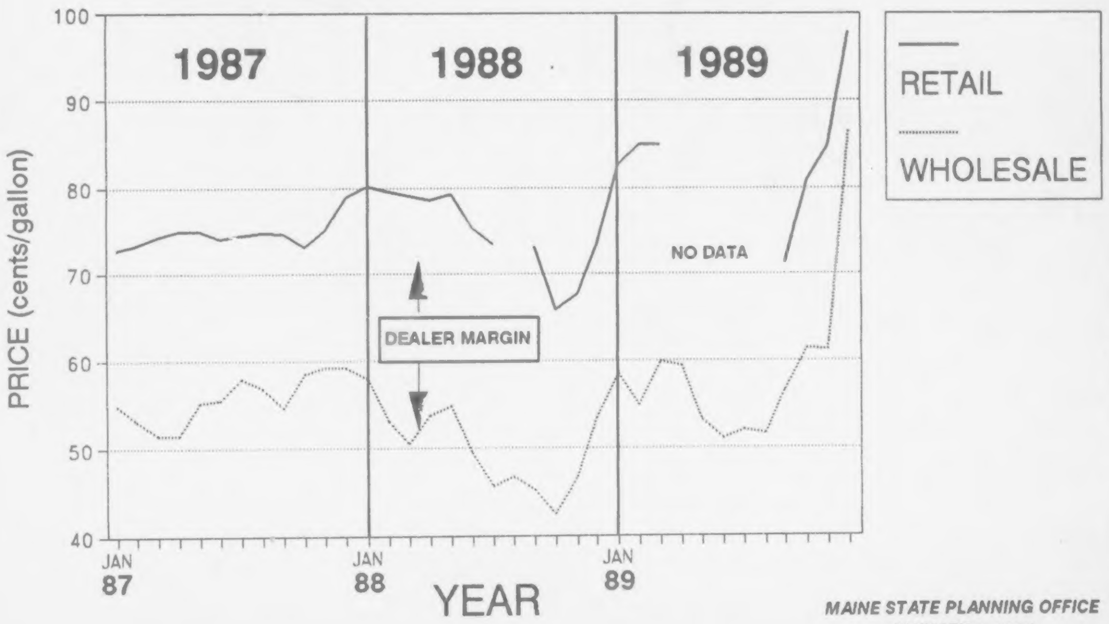


MAINE HOME HEATING OIL COST

1989 - 1990 WEEKLY SURVEY

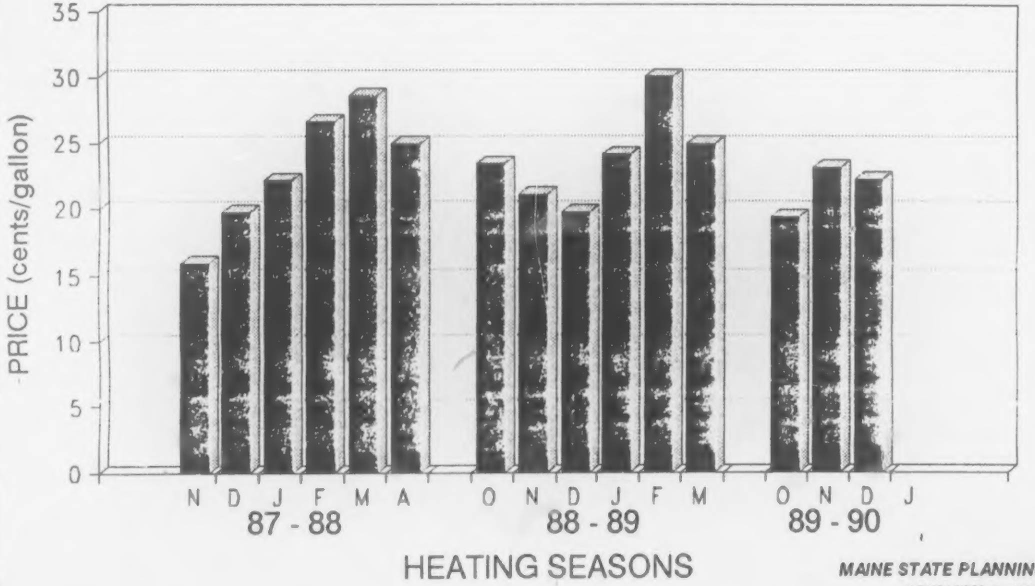
MAINE STATE PLANNING OFFICE
JANUARY 4, 1990

MAINE HOME FUEL OIL COST
MONTHLY AVERAGE FOR 1987 - 1989



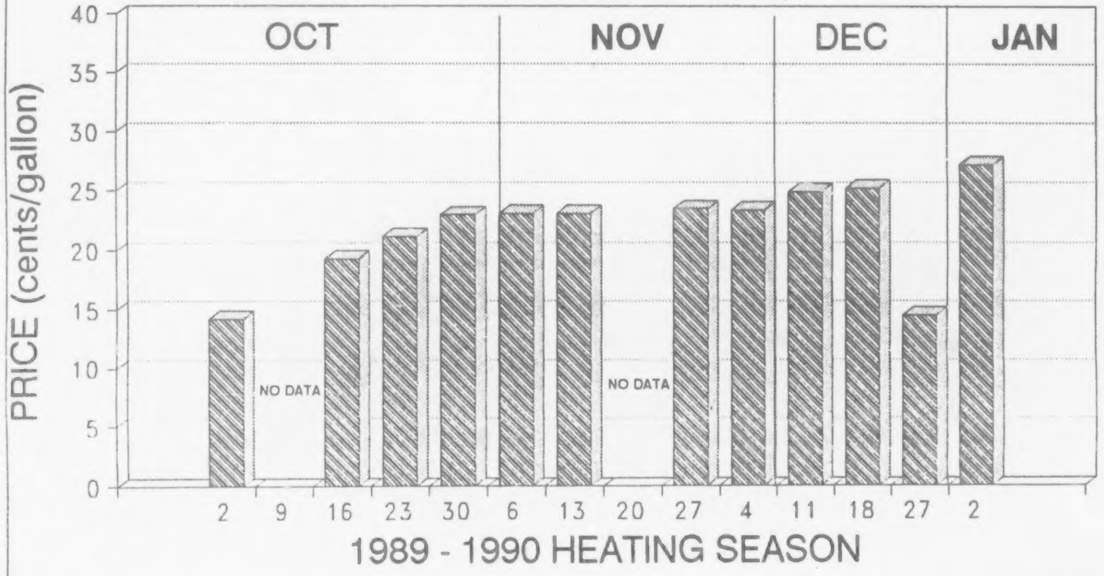
MAINE STATE PLANNING OFFICE
JANUARY 4, 1990

MAINE HOME HEATING OIL
DEALER MARGIN (MONTHLY AVERAGE)

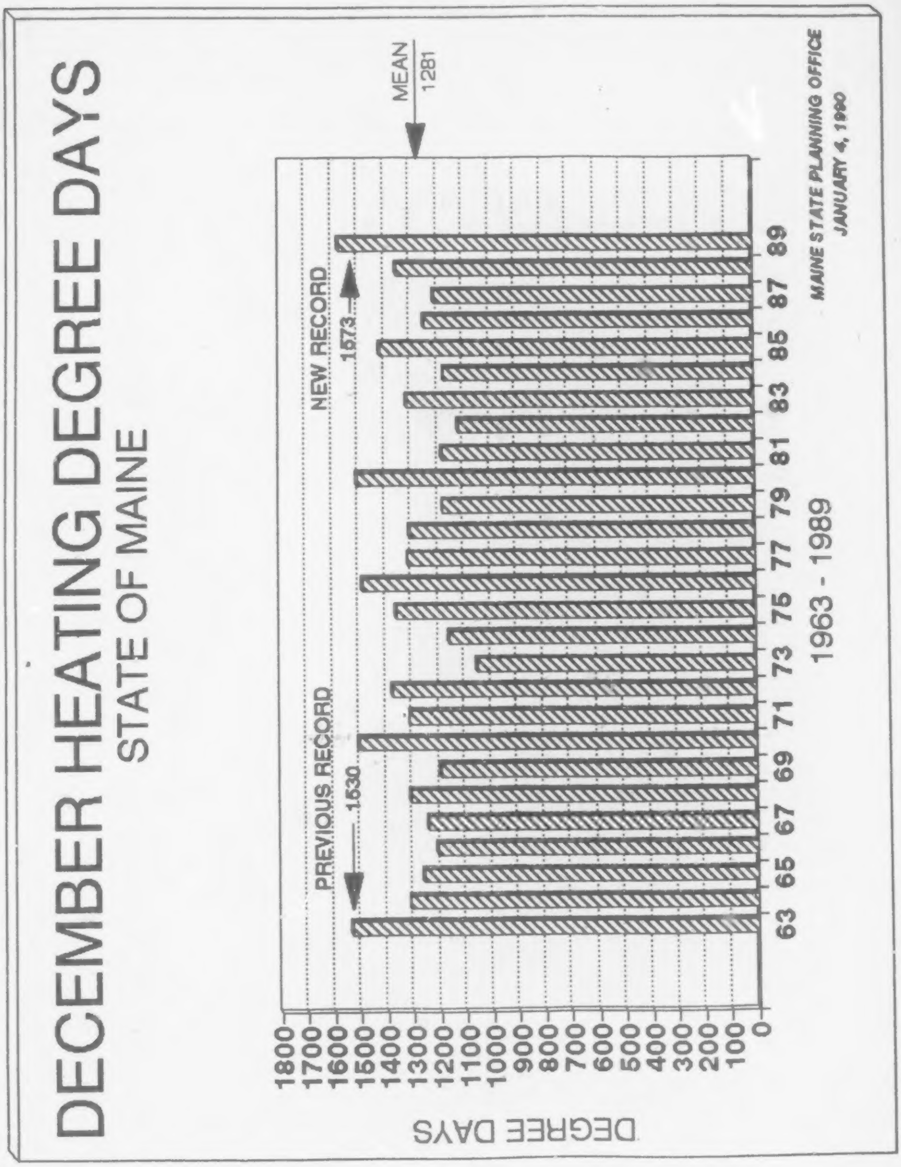


MAINE STATE PLANNING OFFICE
JANUARY 4, 1990

MAINE HOME HEATING OIL
DEALER MARGIN (WEEKLY SURVEY)



MAINE STATE PLANNING OFFICE
JANUARY 4, 1990

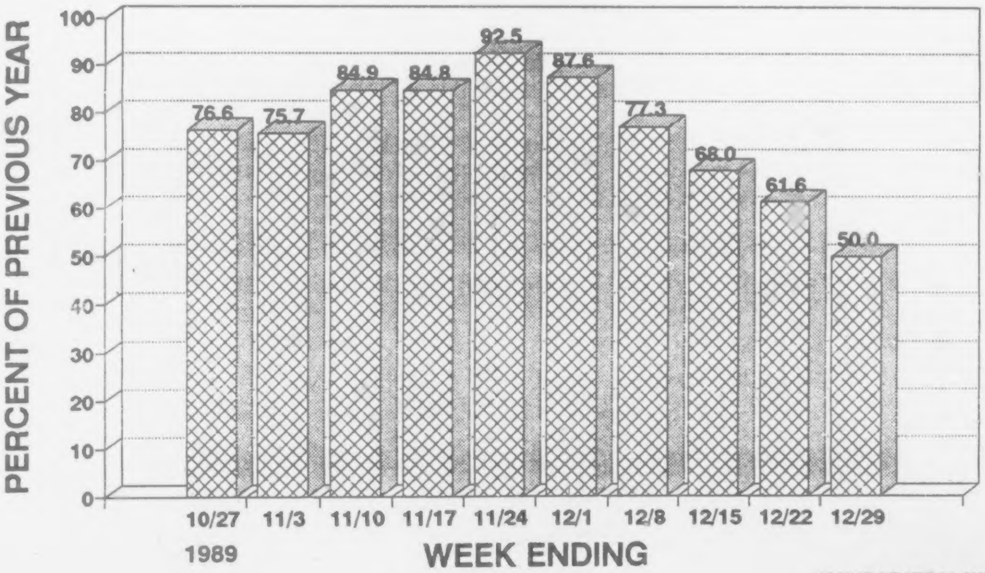


DECEMBER HEATING DEGREE DAYS
STATE OF MAINE

MAINE STATE PLANNING OFFICE
JANUARY 4, 1990

DISTILLATE INVENTORY
NEW ENGLAND WEEKLY SURVEY

PERCENT OF PREVIOUS YEAR



DATA SOURCE: AMERICAN PETROLEUM INSTITUTE

MAINE STATE PLANNING OFFICE
JANUARY 9, 1990

[illegible]

United States Senate
COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

February 28, 1990

The Honorable Wendy L. Gramm
Chairman
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

Dear Ms. Gramm:

The Senate Governmental Affairs Committee conducted a hearing on January 16, 1990 on the dramatic increase in the cost of home heating oil and propane fuel for residents in the Northeast and Midwest regions of the country. One question that several witnesses raised at the hearing was the effect that the futures market may have had on the price increases.

Dr. Helmut Merklein, Administrator of the Energy Information Administration, testified that the futures market "has tended to dampen (preseason) inventories" of home heating oil. Mr. Glenn Tilton, President of Texaco Refining and Marketing, Inc., testified that "the Mercantile Exchange and the proactive nature of the Mercantile Exchange in setting price for distillate had introduced, unquestionably, a level of volatility into the price mechanism for the product [home heating oil]." Other witnesses provided similar testimony.

In order to understand what factors affected the price of home heating oil and propane fuel this winter, we request that CFTC provide the Committee with an analysis of the role that the futures market played in the supplies and prices of these fuels this winter. Please include in your analysis: (1) an explanation of the volatility of prices noted above and any recommendations on steps that might be taken to better manage or control price volatility; (2) an evaluation of the interaction between the futures market and the cash market and the effect this may have had on the price and supply of heating fuels; (3) your assessment of the extent to which major refiners and/or speculators influenced prices and supplies in the futures market and the cash market (including the New York Harbor spot price); and (4) a summary of, and your opinion on, the performance of the Mercantile Exchange in overseeing trading on the heating oil and propane futures market during December 1989 and January 1990.

If you have any questions about this request, please have your staff contact Aaron Bayer at 224-4041 or Linda Gustitus at 224-3682.

Thank you for your attention to this request.

Sincerely,

John Glenn
John Glenn, Chairman

Joseph I. Lieberman

William S. Cohen

Carl Levin

Herb Kohl
Herb Kohl

Claiborne Pell

COMMODITY FUTURES TRADING COMMISSION
2033 K STREET, N.W., WASHINGTON, D.C. 20581
(202) 254-6970
(202) 254-6265 FACSIMILE

OFFICE OF
THE CHAIRMAN

April 3, 1990

The Honorable Joseph I. Lieberman
Committee on Governmental Affairs
United States Senate
SH-502 Hart Senate Office Building
Washington, D.C. 20510-0703

Dear Senator Lieberman:

This letter is in response to your letter of February 28, 1990, in which you asked the Commission to provide your Committee with an analysis of the role that the futures market played in the supplies and prices of heating oil and propane gas this winter. I appreciate the opportunity to provide you with the Commission's perspective on this matter.

The Commission operates an extensive market surveillance program that monitors every actively traded futures market each day for threats of manipulation or market disruption. We place special emphasis on expiring contracts because they are most vulnerable to manipulation. The Commission intensively monitored the New York Mercantile Exchange's (NYMEX) January 1990 heating oil and propane contracts as sharp price increases in cash and futures markets developed in conjunction with the extremely cold weather experienced in many parts of the country, particularly in the Northeast. The January futures were the expiring energy contracts during the December price advance.

The NYMEX heating oil futures market has become an integral part of the heating oil marketing system. In this market many buyers and sellers come together in an open and competitive arena to determine a price for heating oil delivered during specified future periods. The NYMEX heating oil price has become a reference price against which other heating oil prices, that are set in a less public manner, can be compared. This contract calls for delivery of 42,000 gallons of heating oil in New York Harbor by barge, tanker, truck, pipeline or book transfer at a storage facility. However, since futures markets primarily serve risk transfer rather than merchandising functions, most contracts do not result in the delivery of heating oil but rather are liquidated by offsetting trades. The futures market price reflects the wholesale level in the marketing chain, and can differ substantially from the price charged retail customers.

The NYMEX propane futures contract, which specifies delivery of 42,000 gallons of propane at storage facilities in

Mont Belvieu, Texas, is a small and thinly traded contract. Open interest in the January contract generally was less than 400 contracts during December, and daily volume generally was less than 200 contracts per day. The detailed analysis answering your specific concerns will concentrate on the far larger heating oil market. The discussion generally is equally appropriate for propane.

(1) An explanation of the volatility of prices and any recommendations on steps that might be taken to better manage or control price volatility.

As part of its surveillance program, the Commission carefully monitors futures market prices and price relationships in order to determine if the expiring future is in proper alignment with deferred futures and the cash market. Prices in futures markets, especially in agricultural and energy markets, are highly sensitive to extreme weather conditions. Unanticipated weather conditions, such as the cold snap that hit the nation in December, can abruptly change the underlying fundamentals of markets, often requiring a significant price adjustment to bring supply and demand back into equilibrium. The price acts to ration supply among competing demands.

Officials of the Department of Energy (DOE), testifying before your Governmental Affairs Committee on January 16, 1990, attributed the sharp rise in the wholesale price of heating oil primarily to a sharp increase in demand for heating oil due to the extremely cold weather, and, secondarily, to supply factors. Distillate demand in the U.S. increased by almost 1.0 million barrels per day, or 33 percent, to 4.1 million barrels in December, the largest one-month increase in at least a decade, most of which occurred on the East Coast. This increase was almost three times larger than the more typical rise during December 1988, and more than double that seen in December 1983, when prices also rose sharply in response to a sudden cold snap. DOE stated that the enormous increase in distillate demand was generated by the unexpected, widespread cold wave, which blanketed most of the U.S. in December. December was 27 percent colder than normal nationally (and 29 percent colder than last December), and 33 percent colder than normal on the East Coast (the coldest December in at least 60 years).

Among the supply factors cited by DOE were low inventory entering the heating oil season, production reductions as a result of the complete shutdown of a number of refineries due to the cold weather and/or fires and explosions, and short term transportation bottlenecks. Although DOE cited the emergence of futures markets as one of several factors which may have altered refiner and distributor inventory behavior, the Commission believes that this was a minor factor in comparison to the tremendous increase in demand caused by the cold weather.

The Commission's surveillance of the heating oil futures market has not uncovered evidence of manipulative activity in the futures market as a cause of the rise in heating oil prices in December 1989. We agree with the DOE that the rise in heating oil prices in December was caused by fundamental factors, primarily the sharp increase in demand caused by the cold weather.

Neither its legislative mandate nor its area of expertise qualifies the Commission to offer recommendations on how the energy industry should better prepare for such unusual weather. However, I can assure you that should such a situation recur, the Commission will continue to intensively monitor the futures market to detect and prevent market disruptions caused by improper futures market trading.

(2) An evaluation of the interaction between the futures market and the cash market and the effect this may have had on the price and supply of heating fuels.

The price relationships in heating oil during December 1989 were signaling a critically tight supply-demand balance that was expected to be short term and particularly acute in the Northeast. Normally, the cash price and the expiring futures price are very close. As can be seen in the enclosed table and price chart, however, the January futures price trailed the New York Harbor spot market price during all of December, and the cash premium widened significantly as the month progressed, suggesting that futures market prices were reflecting, rather than leading, cash market prices. The cash premium to the January futures price is not surprising since in December an extraordinarily large and immediate need for spot heating oil developed; taking delivery on the January contract would probably result in getting heating oil in late January after that peak demand had passed. Similarly, the January futures premium to the February contract widened to unusually large levels during December, apparently because the market anticipated that by February the supply shortage would be relieved.

(3) Our assessment of the extent to which major refiners and/or speculators influenced prices and supplies in the futures market and the cash market (including the New York Harbor spot price).

The Commission routinely obtains, on a daily basis, reports concerning all positions in heating oil futures which equal or exceed 150 contracts (150,000 barrels) in any futures month. Our surveillance economists analyze these position reports, looking for situations which may pose a threat of a market disturbance. Among other things, we look for any concentrated position, especially if the position is large relative to total open interest and potential deliverable supply. The Commission has no evidence that the sharp price increase in heating oil was caused by concentrated futures market positions. We did not observe uneconomic behavior by the largest traders in the futures market.

The position reports also show position by type of trader, *i.e.*, commercial and noncommercial (speculative) traders. Reporting commercial traders held 53.3 percent of the total long-side open interest and 63.2 percent of the total short-side open interest as of December 29, 1989. Reporting noncommercial traders held only 13.6 percent and 3.9 percent of the long and short-side open interest respectively on this same date. Speculative position holding in the January 1990 future was also quite small. It does not appear to be the case, therefore, that excessive speculation by noncommercial traders in the heating oil futures market caused the sharp price rise in heating oil prices. In summary, the Commission has no information that refiners or speculators unduly influenced heating oil futures prices during December and January.

(4) A summary of, and our opinion on, the performance of the Mercantile Exchange in overseeing trading on the heating oil and propane futures market during December 1989 and January 1990.

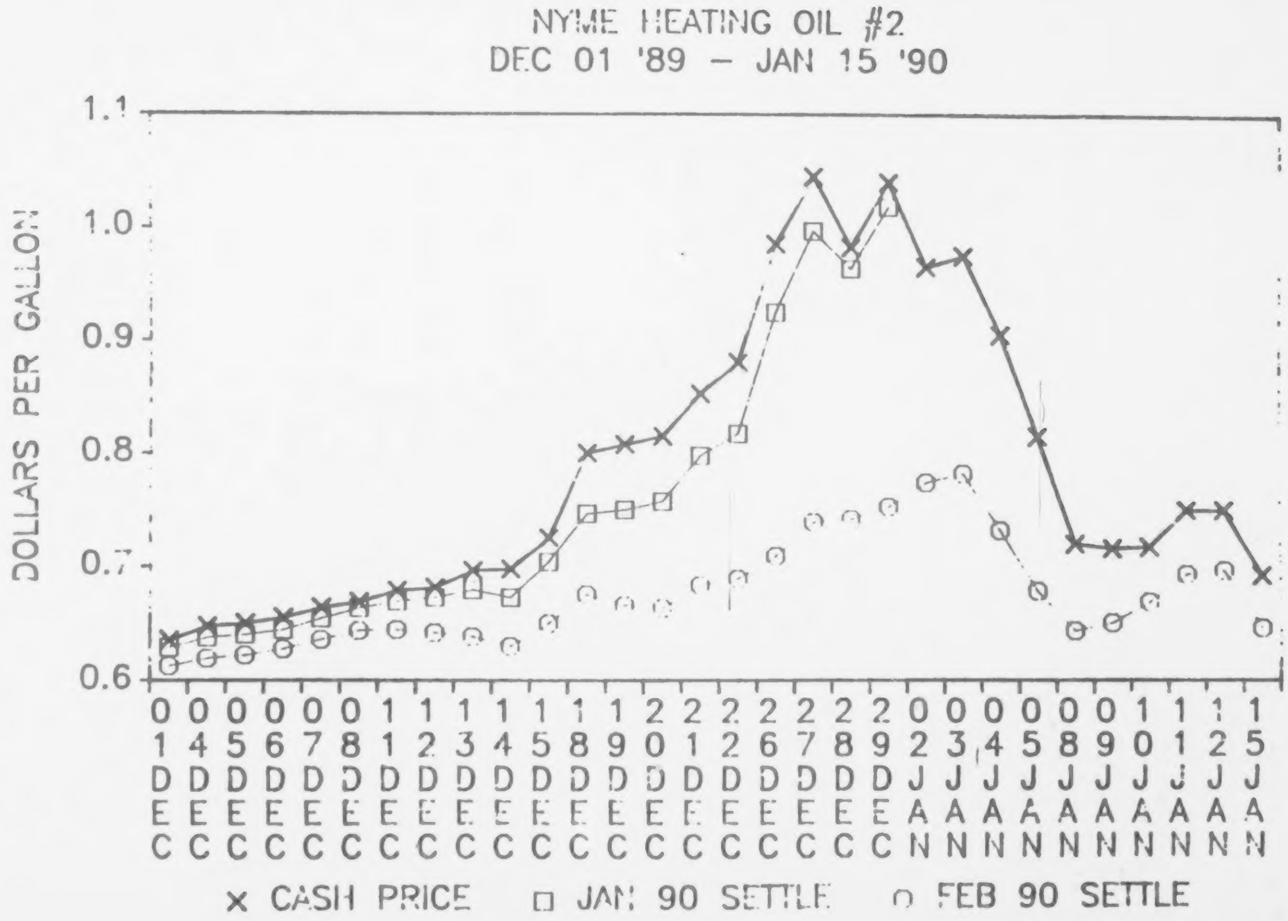
Our staff was in almost daily contact with NYMEX regarding these contracts in order to exchange information and to monitor NYMEX's performance of its self-regulatory responsibility to maintain orderly markets. NYMEX was in contact with all the major traders in the January contracts in order to assess their intentions and to determine whether there would be adequate supply to meet the likely demand for delivery. In our view, NYMEX staff did a good job monitoring these markets during December and into the January delivery period.

Thank you for your interest in the Commission's programs. If you should have any further concerns on this matter, please contact me.

Very sincerely yours,

Wendy L. Gramm
Chairman

Enclosures


NYME HEATING OIL #2
DEC 01 '89 – JAN 15 '90
DOLLARS PER GALLON
1.1
1.0
0.9
0.8
0.7
0.6
01 DEC
04 DEC
05 DEC
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12 JAN
15 JAN
× CASH PRICE
□ JAN 90 SETTLE
○ FEB 90 SETTLE

CASH AND FUTURES SETTLEMENT PRICES
FOR HEATING OIL # 2
DECEMBER 1, 1989 - JANUARY 15, 1990
(dollars per gallon)

DATE	JAN 90 SETTLE	FEB 90 SETTLE	CASH PRICE	BASIS (CASH MINUS NEARBY FUTURE)
01DEC	0.6291	0.6125	0.6350	0.0059
04DEC	0.6379	0.6190	0.6475	0.0096
05DEC	0.6405	0.6218	0.6500	0.0095
06DEC	0.6446	0.6273	0.6550	0.0104
07DEC	0.6547	0.6355	0.6637	0.0090
08DEC	0.6637	0.6433	0.6687	0.0050
11DEC	0.6695	0.6442	0.6787	0.0092
12DEC	0.6730	0.6415	0.6812	0.0082
13DEC	0.6796	0.6380	0.6962	0.0166
14DEC	0.6728	0.6296	0.6975	0.0247
15DEC	0.7042	0.6496	0.7250	0.0208
18DEC	0.7466	0.6749	0.8000	0.0534
19DEC	0.7501	0.6655	0.8075	0.0574
20DEC	0.7576	0.6631	0.8150	0.0574
21DEC	0.7981	0.6831	0.8525	0.0544
22DEC	0.8174	0.6889	0.8800	0.0626
26DEC	0.9248	0.7089	0.9850	0.0602
27DEC	0.9971	0.7389	1.0450	0.0479
28DEC	0.9640	0.7417	0.9825	0.0185
29DEC	1.0187	0.7525	1.0400	0.0213
02JAN		0.7739	0.9650	0.1911
03JAN		0.7820	0.9750	0.1930
04JAN		0.7319	0.9050	0.1731
05JAN		0.6783	0.8150	0.1367
08JAN		0.6433	0.7200	0.0767
09JAN		0.6505	0.7162	0.0657
10JAN		0.6688	0.7175	0.0487
11JAN		0.6932	0.7500	0.0568
12JAN		0.6965	0.7500	0.0535
15JAN		0.6460	0.6925	0.0465

Source: New York Mercantile Exchange, Daily Futures Report, and Platt's Oilgram Price Report (No. 2 Heating Oil, New York barge delivery)

Department of Energy
Washington, DC 20585

January 17, 1989

The Honorable Joseph I. Lieberman
Committee on Governmental Affairs
United States Senate
Washington, D. C. 20510

Dear Senator Lieberman:

During the testimony on heating oil prices that was held before the Senate Governmental Affairs Committee on January 16, 1990, you inquired about the profitability of the oil industry. I mentioned that the oil industry has not been particularly profitable.

The attached documentation supports this view. As you can see on page 3 of the enclosed report entitled U. S. Energy Industry Financial Development 1989, Third Quarter, the Energy Information Administration's Energy Group of 65 companies had a lower return on equity than the Standard and Poor's (S&P) 400 Industry Group quarter after quarter since 1984. Since 1986, energy rates of return have been significantly below those of the nonenergy S&P 400 Companies.

This performance profile is duplicated by the major oil companies as well. The enclosed Chapters 1 and 2 from our forthcoming publication entitled Performance Profiles of Major Energy Producers, 1988, show that the rates of return of major producers rose briefly above those of the nonenergy S&P 400 Corporations in the immediate aftermath of the 1973/74 embargo and again after the Iranian revolution. Both periods were characterized by very steep increases in crude oil prices. However, since 1984 the major oil companies have performed at a rate of return that was considerably less than that of the nonenergy S&P 400 Corporations, at least through 1988. That year, which reflected a noticeable improvement over earlier years, the return on equity of the nonenergy S&P 400 Corporations was 16.9 percent, compared to 13.6 percent for the Major Energy Producers. Data for 1989 will not become available for some time.

I hope this information is helpful in your deliberations.

Sincerely,

H.A. Merklein

Dr. H. A. Merklein
Administrator
Energy Information Administration

Enclosures

cc:
The Honorable John Glenn
Chairman

The Honorable William V. Roth, Jr.
Ranking Minority Member

Members, Committee on Governmental Affairs

The Honorable Sam Nunn
The Honorable Carl M. Levin
The Honorable Jim Sasser
The Honorable David H. Pryor
The Honorable Jeff Bingaman
The Honorable Herbert H. Kohl
The Honorable Ted Stevens
The Honorable William S. Cohen
The Honorable Warren Rudman
The Honorable John Heinz
The Honorable Pete Wilson

U.S. Energy Industry Financial Developments 1989 Third Quarter

Macro and Financial Information Branch
Economics and Statistics Division
Office of Energy Markets and End Use
Energy Information Administration

November 1989

Contacts

U.S. Energy Industry Financial Developments, 1989 Third Quarter was prepared by the Macro and Financial Information Branch, Economics and Statistics Division, Office of Energy Markets and End Use, Energy Information Administration, U.S. Department of Energy. For further information concerning this report, contact T. Crawford Honeycutt on (202)586-1420.

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Executive Summary

In the third quarter of 1989 (Q389), the aggregate net income of 215 energy companies fell by 6 percent to $10.3 billion, compared with the third quarter of 1988 (Q388). Net income for 19 major petroleum companies fell 14 percent. These firms reported that decreases from refining, chemicals, and nonenergy businesses outweighed improved income from oil and gas production.

Buoyed by higher oil prices, 48 independent oil and gas producers reported aggregate income of $17 million in Q389 compared with losses of $21 million in Q388. For the majors that disclosed line-of-business information, domestic oil and gas production income nearly tripled.

As a group, eight independent refining/marketing companies reported a 48-percent decline in net income due to lower margins and a rapid accretion of product stocks in July. For the majors disclosing line-of-business data, U.S. refining income decreased by 37 percent in the third quarter.

Even though U.S. drilling activity continued to decline during Q389, oil and gas profitability increased. Improved prices, cost cutting, and restructuring apparently contributed to improved financial results. Oil field companies registered a 57-percent increase in net income between Q388 and Q389 and their revenue rose 4 percent.

The 113 rate-regulated energy companies included in this report registered a 1-percent increase in net income. Gas transmission and distribution companies' income increased due to industrial demand and modestly higher prices. Milder weather conditions led to a reduction in electricity generation and slightly reduced income for electric utilities.

Introduction

This report traces key financial trends in the U.S. energy industry and several of the industry's major segments for the third quarter of 1989. Financial data for companies are included in two broad groups--fossil fuel production and rate-regulated utilities. All financial data were taken from public sources such as *The Wall Street Journal*, corporate reports, and energy trade publications. Each company was assigned to a particular segment based on revenue. Revenue may or may not be net of excise taxes, depending on the reporting practices of the companies.

An effort is made to assure that period-to-period comparisons reflect actual operating results rather than accounting changes. The income measure shown in this report is net income from continuing operations, excluding extraordinary gains or losses which a company may report from the sale or valuation change of a major asset or for reserve provisions relative to possible future adverse legal judgments.

Since several major petroleum companies disclose income by lines of business and geographic area, these data are summarized where possible. Although the disaggregated income concept varies by company and is not strictly comparable to corporate income, relative movements in income by lines of business and geographic area are summarized as useful indicators of short-term changes in the underlying profitability of these operations.

Financial and Energy Overview

Higher oil prices and milder weather had adverse effects on the financial performance of U.S. energy companies in the third quarter of 1989 (Q389) compared with the third quarter of 1988 (Q388).[1] Higher oil prices led to generally higher energy prices which served to reduce consumption. Milder weather in Q389 reduced both the number of heating and cooling degree days compared with Q388 also reduced demand. All sources of U.S. energy production, except natural gas, registered declines (Table 1).

Table 1. Energy Statistics[a]

Supply and Prices	Q389	YTD89	Percent Change from Q388	Percent Change from YTD88
Energy Supply				
Crude Oil Production (million b/d)	7.5	7.7	-5.8	-6.5
Net Imports[b] (million b/d)	6.2	5.6	23.8	15.0
Refined Product Supplied (million b/d)	16.8	17.1	-1.7	-0.1
Net Product Imports (million b/d)	1.3	1.5	-21.7	-4.2
Natural Gas Production (trillion cubic feet)	4.0	12.5	1.0	1.0
Net Imports (trillion cubic feet)	0.3	0.9	7.4	4.5
Coal Production (million short tons)	237	723	-1.7	2.6
Net Electricity Generated (billion kWh)	729.8	2,069.6	-2.0	1.0
Net Imports (billion kWh)	8.3	18.3	-12.6	-30.7
Energy Prices				
Refiner Acquisition Cost of Imported Crude Oil (dollars per barrel)	17.60	17.78	22.6	16.9
Gasoline, Retail (dollars per gallon)	1.11	1.07	12.1	11.1
Electricity, Residential (cents per kWh)	8.03	7.66	1.5	2.2
Natural Gas, Residential (dollars per thousand cf)	6.85	6.02	0.4	2.5

[a] Data for the most recent periods are preliminary estimates.
[b] Includes imports for the Strategic Petroleum Reserve.
Percent change calculated from data presented in the cited source.
Source: Energy Information Administration, *Short-Term Energy Outlook, Quarterly Projections*, October 1989, DOE/EIA-0202(89/4Q) (Washington, DC, November 1989) and *Monthly Energy Review* August 1989, DOE/EIA-0035(89/08) (Washington, DC, November 1989).

Revenue of the 215 energy companies increased by 5 percent to $159 billion largely due to higher prices (Table 2). However, their net income fell by 6 percent to $10.3 billion. Net income of industrial companies outside the energy industry fell at steeper 11-percent rate between Q388 and Q389. As a result, the gap in profitability between the energy industry and other industrial companies narrowed slightly (Figure 1).

Financial performance varied among the energy segments. In petroleum operations, oil and gas producers and oil field companies continued to register gains in income but refiners experienced a substantial fall in income. Reduced income from the major energy companies' chemical operations also contributed to a decline in bottom-line results. Within the rate-regulated energy sector, natural gas transmission and distribution companies posted income gains in Q389 compared with Q388. Electric utilities evidenced a slight fall in net income. However, the results for electric utilities varied considerably by region.

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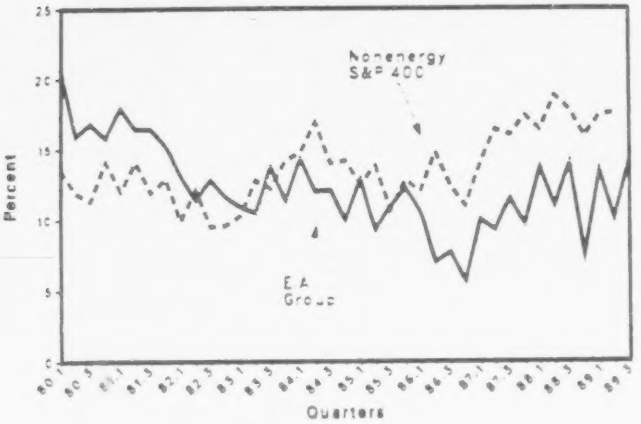
[1] The energy data used in this report are taken from the Energy Information Administration, *Short-Term Energy Outlook, Quarterly Projections*, October 1989, DOE/EIA-0202(89/4Q) (Washington, DC, November 1989). These are preliminary estimates and may differ from final data when they are published.

Figure 1. EIA Energy Group and Nonenergy S&P 400, Return on Equity, 1980-1989



Source: Standard & Poor's Compustat Services, Inc.
The data for the third quarter of 1989 are estimated.

Table 2. Revenue and Income Summaries[*]
(Million Dollars)

Energy Industries	Q389	YTD89	Percent Change from Q388	Percent Change from YTD88
Fossil Fuel Industries				
Revenue				
Major Petroleum Companies (19)	98,590.7	300,855.9	4.8	5.9
Independent Oil and Gas Producers (48)	2,256.7	6,761.5	9.4	12.8
Independent Refiner/Marketers (8)	5,158.2	12,372.7	8.9	7.2
Oil Field Companies (20)	4,068.1	11,173.9	3.8	3.8
Petroleum Subtotal (95)	110,073.7	331,164.0	5.0	6.0
Coal (7)	1,253.9	3,431.6	23.2	17.5
Fossil Fuel Subtotal (102)	111,327.7	334,595.7	5.2	6.1
Income				
Major Petroleum Companies	4,352.8	14,965.7	-14.2	-0.5
Independent Oil and Gas Producers	17.3	334.0	NM	1,364.4
Independent Refiner/Marketers	103.7	302.9	-48.2	-17.4
Oil Field Companies	218.3	505.4	56.9	32.3
Petroleum Subtotal	4,692.2	16,108.1	-13.0	1.9
Coal	46.8	133.6	4.0	-12.8
Fossil Fuel Subtotal	4,739.0	16,241.7	-12.9	1.8
Rate-Regulated Energy Industries				
Revenue				
Natural Gas Transmission (15)	8,281.5	27,488.8	11.3	6.2
Natural Gas Distribution (22)	2,975.9	10,579.7	3.6	8.3
Electric Utilities (76)	36,619.4	70,411.1	2.6	3.3
Rate-Regulated Subtotal (113)	47,876.8	108,479.7	4.1	4.5
Income				
Natural Gas Transmission	92.8	952.0	NM	28.9
Natural Gas Distribution	13.4	518.6	NM	6.5
Electric Utilities	5,420.1	9,171.3	-1.2	-2.3
Rate-Regulated Subtotal	5,526.3	10,641.9	0.8	0.3
Total Energy Industry Revenue (215)	159,204.5	443,075.3	4.8	5.7
Total Energy Industry Net Income	10,265.3	26,883.7	-6.1	1.2
Nonenergy Industrial Companies' Net Income (321)	20,554.6	NA	-10.9	NA

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[*] The number of companies is reported in parentheses.

NA=Not available.

NM=Not meaningful. Oil and gas producers, natural gas transmission, and natural gas distribution companies reported losses of $21 million, $2 million, and $3 million, respectively, in Q388.

Sources: Compiled from companies' quarterly reports to stockholders and "Earnings Digest," *The Wall Street Journal*, various issues, October and November 1989. Data for the nonenergy group were presented in *The Wall Street Journal*, November 6, 1989. *The Wall Street Journal* group is adjusted to exclude energy and non-manufacturing companies.

Fossil Fuel Industries

Oil and Gas Producers

An increase in oil prices in excess of $3 per barrel and slightly higher natural gas production more than offset the adverse effects of a 6-percent decline in U.S. oil production on the net income of oil and gas producers. The 48 independent oil and gas producers that are included in Table 2 reported total net income of $17 million in Q389 compared with a loss of $21 million in Q388. Over the same period, income from U.S. oil and gas production nearly tripled for the major energy companies that disclosed results separately for this segment (Table 3). The major energy companies' foreign oil and gas production operations registered a lesser 13-percent increase due to slow recovery of North Sea production and expenses associated with the acquisition of Dome Petroleum by Amoco.

Refining/Marketing

While estimated average product realizations increased by over $2 per barrel from Q388, the estimated refiner acquisition cost of crude oil increased by over $3 per barrel.[2] As a result, the gross refiners' margin declined from the third quarter of 1988 (Figure 2). Refiners' attempts to increase product prices in line with crude oil prices were thwarted as consumers curtailed gasoline consumption sharply during July and August. The resulting excess increase in stocks put severe downward pressure on quarterly cash flow. For example, during July 1989, motor gasoline stocks increased by 12.3 million barrels.[3] Consequently, refiners cut back gasoline production from an average of 7.4 million barrels per day in July to 7.1 million barrels per day in August and September. Refinery utilization rates remained high, however, as the product slate shifted toward distillate production for the coming heating season.

The net result of these developments was that independent refiner/marketers reported a 48-percent fall in income to $104 million during Q389 (Table 2). The relatively strong margins during the spring yielded a lesser 17-percent income decline for the first 9 months. The major petroleum companies disclosing U.S. refining/marketing financial results reported a 37-percent fall in the quarter and a 27-percent fall for the year-to-date. The majors' foreign refining/marketing results yielded similarly disappointing results.

Major Petroleum Companies

The major petroleum companies' net income in Q389 fell by 14 percent, to $4.4 billion.[4] This primarily reflected slumping financial results for U.S. and foreign refining/marketing and chemicals operations (Table 3). Income from U.S. oil and gas production almost tripled as a result of higher oil prices and increased natural gas production. However, abroad, North Sea oil and gas producers reported that output and operating difficulties in the region were being ameliorated but nonetheless continued to adversely affect their earnings. Consequently, income from foreign oil and gas production increased by a lesser 13 percent in the quarter.

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[2] Calculated from data presented in Energy Information Administration, *Petroleum Marketing Monthly*, August 1989, DOE/EIA-0380(89/08) (Washington, DC, November 1989), Tables 1, 4, and 5.

[3] Energy Information Administration, *Weekly Petroleum Status Report*, October 20, 1989, DOE/EIA-0208(89-44) (Washington, DC, October 1989), p. 8.

[4] The 19 companies considered "major" for this report are Amerada Hess, American Petrofina, Amoco, Atlantic Richfield, Chevron, Coastal, Du Pont, Exxon, Kerr McGee, Mobil, Murphy, Occidental, Pennzoil, Phillips, Shell, Sun, Texaco, Union Pacific, and Unocal.

Income from the major petroleum companies' U.S. refining/marketing operations fell 37 percent in Q389 to $822 million. The majors' foreign refining/marketing results fell 19 percent to $503 million during the quarter. Until the second quarter of 1989, chemical operations were an important source of income growth for the majors in recent years. The average quarterly increase in chemical operations' income from the fourth quarter of 1985 through the first quarter of 1989 was 55 percent (based on prior editions of this report). In the second quarter of 1989, the pace of earnings growth from these operations fell to 8 percent.[5] During Q389, income from chemical operations fell 20 percent to $1.5 billion, a victim of higher oil prices and lower margins for some products. Decreased income from nonenergy operations was due in part to restructuring efforts which resulted in divestiture of some of these businesses and reflected the decline in industrial profits generally.

Total capital expenditures of the major petroleum companies in 1989 increased by 3 percent in the quarter but for the first 9 months fell by 3 percent compared with 1988. Expenditures for domestic oil and gas production fell 11 percent, but foreign oil and gas expenditures rose 18 percent. Refining and marketing activities continued to be growing investment targets, with expenditures for these operations rising 4 percent in the quarter and 16 percent in the first 9 months.

Oil Field Services

Despite the large increase in crude oil prices, domestic drilling activity has failed to recover, as potential investors remain uncertain about the profitability of exploration and development expenditures in the United States. The weekly rig count fell to an average of 816 for the first 9 months of the year compared with an average of 941 rigs in the first 9 months of 1988.[6] Further, major petroleum companies cut back domestic exploration and development expenditures, while increasing foreign exploration and development expenditures (Table 3). This continued a trend by the major petroleum companies to increasingly focus exploration and development efforts in areas outside the United States.

Despite lower drilling activity, income of oil field companies improved sharply in the third quarter of this year, by 57 percent relative to the third quarter of last year and by 32 percent for the first 9 months (Table 2). Further, oil field employment increased slightly[7] which is an additional indicator of improved financial prospects. It is also quite likely that the oil field equipment and services companies with foreign operations tended to benefit from increased foreign exploration and development expenditures and by the expenditures required to repair production facilities damaged during the Iran-Iraq war.

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[5] Energy Information Administration, "U.S. Energy Industry Financial Developments," Second Quarter 1989 (Washington, DC, September 1989), Table 3.

[6] Energy Information Administration, *Monthly Energy Review*, July 1989, DOE/EIA-0035(89/07) (Washington, DC, October 1989), Table 5.1.

[7] Data Resources, Inc., *U.S. Central Data Bank*, November 20, 1989.

Table 3. Income and Expenditures for Major Petroleum Companies*
(Million Dollars)

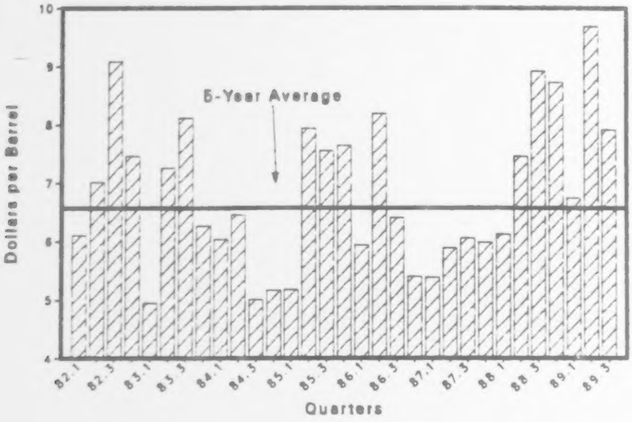
Category	Q389	YTD89	Percent Change from Q388	YTD88
Lines of Business				
Petroleum (13)	3,507	10,508	-0.4	-6.7
Chemicals (11)	1,542	5,630	-20.3	3.0
Coal (5)	110	349	2.4	8.3
Other Businesses (8)	103	396	-29.6	-34.3
Petroleum Income by Geographic Sector				
Domestic (8)	1,373	4,126	1.1	3.4
Foreign (8)	1,401	3,764	4.9	-19.0
Domestic Income by Function				
Oil and Gas Production (8)	800	2,852	196.7	39.3
Refining/Marketing (10)	822	2,043	-37.1	-27.1
Foreign Income by Function				
Oil and Gas Production (9)	910	2,838	12.7	-15.7
Refining/Marketing (6)	503	1,084	-19.3	-31.0
Capital and Exploratory Expenditures				
By Function (6)				
Domestic Oil and Gas Production	805	2,166	-11.4	-22.6
Foreign Oil and Gas Production	868	2,284	18.1	16.2
Refining/Marketing	814	2,291	3.9	15.5
Other Functions	1,047	2,619	31.6	-15.7
Functional Total	3,535	9,361	9.6	-5.0
Other Companies (3)	2,791	7,806	-5.1	0.8
Total Capital and Exploratory Expenditures (9)	6,326	17,167	2.6	-2.5

*The number of companies is reported in parentheses.
Source: Compiled from companies' quarterly reports to stockholders.

Coal Production

Coal production fell by 2 percent during Q389 as a result of strike activity in the eastern coal fields. However, the effect of lower production was concentrated in a small number of coal producers. Four coal companies reported improved financial performance and three companies reported a decline in earnings. Pittston, the company most affected by strikes, had a 78-percent decline in net income between Q388 and Q389. As a result, coal producers' financial results were mixed. In total, coal producers reported a 4-percent increase in income compared with Q388 and a 13-percent decline compared with the first 9 months of 1988 (Table 2). Net income from the coal operations of major petroleum companies rose 2 percent for the quarter and 8 percent for the year (Table 3).

Figure 2 Gross Refining Margin, 1982-1989



Source: Energy Information Administration, *Petroleum Marketing Monthly*, August 1989, DOE/EIA–0380(89/07) (Washington, DC, November 1989).
Data for the third quarter of 1989 are EIA estimates.

Rate-Regulated Energy Industries

The 113 rate-regulated energy companies included in Table 2 reported income of $5.5 billion, a 1-percent increase compared with Q388. Natural gas transmission and distribution companies were responsible for the increase.

Natural Gas

Natural gas consumption increased by 3 percent in the third quarter compared with last year.[8] A substantial, 8-percent increase in industrial gas consumption was primarily responsible for the increased consumption. The increase in industrial demand reflected a shift away from petroleum in response to higher prices. The gas transmission companies were particularly benefited by increased gas deliveries. The transmission companies' improved results also reflected their adjustment to the evolving regulatory environment of recent years. Overall, the gas transmission companies reported a $95 million turnaround from losses of $2 million in Q388 to income of $93 million in Q389 (Table 2). For the year-to-date, income was 29 percent higher. The distribution companies' income increased from losses of $3 million in Q388 to income of $13 million in Q389.

Electricity

Electricity generation was 3 percent lower in Q389 than in Q388, which is a reflection of both fewer heating and fewer cooling degree days in Q389 than in Q388. On the east coast, untypically heavy rainfall restrained summer temperatures. Residential electricity prices increased by 2 percent (Table 1), but on balance electric utilities' income fell by 1 percent in the quarter and 2 percent for the year-to-date (Table 2). Electric utilities in the northeast and southeast regions registered declines in income while other electric utilities overall experienced a modest rise in income between Q388 and Q389.

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[8] Energy Information Administration, *Short-Term Energy Outlook, Quarterly Projections*, October 1989, DOE/EIA-0202(89/4Q) (Washington, DC, November 1989), Table 14.

DOE/EIA-0206(88)
Distribution Category UC-98

Performance Profiles of Major Energy Producers 1988

-- DRAFT -- 1/17/90 1PM

Energy Information Administration
Office of Energy Markets and End Use

This report was prepared by the Energy Information Administration, the independent statistical and analytical agency within the Department of Energy. The information contained herein should not be construed as advocating or necessarily reflecting any policy position of the Department of Energy or any other organization.

1. Introduction

Major energy companies annually report to the Energy Information Administration (EIA) on Form EIA-28. These reports include data and information on their financial and operating developments. For the reporting year 1988, 23 companies filed this information.[1] The EIA Financial Reporting System (FRS) program maintains a data base of this information covering developments since 1974.[2] The analysis and data presented in this report depict the operations of the FRS companies in the context of their worldwide operations and in the context of the major energy markets which they serve. The report analyzes the energy and nonenergy developments of the FRS companies, developments in their major lines of business and in segments within the petroleum line of business, and developments across geographic areas in which they operate.[3]

The 23 FRS companies occupy a major position in the U.S. economy.[4] In 1988, their sales were equal to 20 percent of the $2.0 trillion in sales by Fortune's list of the 500 largest U.S. industrial corporations, and their profits and assets were equal to 23 percent and 21 percent, respectively, of those of the Fortune 500 companies. Of the top 25 industrial companies (based on sales) in 1988 on the Fortune 500 list, 12 were FRS companies including one of the FRS companies which had been on the Fortune 500 list before becoming wholly foreign owned.

The reporting companies engage in a wide range of business activities, but their most important activities are in the energy sector. About 76 percent, or $328 billion, of allocated operating revenues were derived from energy sales. Nearly all of these sales involve petroleum (Figure 1). (For purposes of this report, petroleum is defined to include natural gas.)[5]

In 1988, the FRS companies accounted for 59 percent of total U.S. crude oil and natural gas liquids production, 46 percent of U.S. natural gas production,[6] and 76 percent of U.S. refinery capacity (Figure 2 and Table B1). The bulk of the FRS companies' assets, as well as their new investments, is devoted to sustaining various aspects of petroleum production, processing, transportation, and marketing. Nonenergy businesses accounted for about 24 percent, or $105 billion, of the FRS companies' allocated revenues in 1988.

Relative to petroleum, production of energy sources other than petroleum by FRS companies is not large. The combined operating revenues of coal, nuclear, and nonconventional energy operations of the FRS companies totaled $7.2 billion in 1987, or slightly less than 2 percent of allocated revenues. Nonetheless, FRS companies are significant participants in these markets. For example, the FRS companies produced 30 percent of all U.S. coal output in 1988 and 24 percent of all U.S. uranium oxide. However, these and other nonpetroleum energy activities did not contribute greatly in the aggregate to the overall profits of the FRS companies.

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[1] The companies that reported to the FRS system for each of the years 1977 through 1988 are listed in Appendix A.

[2] In addition to the data provided by the detailed statistical tables in Appendix B and in the appendices of previous versions of this report, aggregate time series data from Form EIA-28 for 1977 through 1983 were published in Energy Information Administration, *Performance Profiles of Major Energy Producers 1983*, Volume 2, DOE/EIA-0206(83/2). Aggregate time series data from Form EIA-28 for 1974 through 1988 can be obtained from the EIA (see Contacts, p. ii). Additionally, a special post embargo report covering the period 1974 through 1980 was issued. See Energy Information Administration, *Energy Company Development Patterns in the Post-embargo Era*, Vol. 1 and Vol. 2, DOE/EIA-039.

[3] The requirement to collect and analyze information is in Public Law 95-91, August 4, 1977, the Department of Energy Organization Act, 91 Stat. 573.

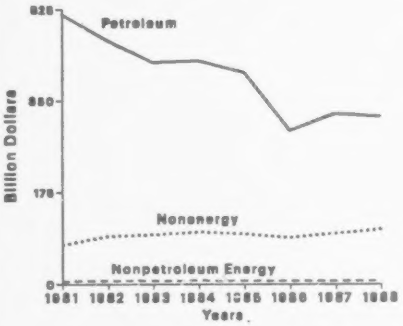
[4] For purposes of this report, the term United States typically includes the 50 States, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

[5] Natural gas and oil are collectively referred to as petroleum, since many of their financial aspects cannot be separated. However, data on sales, production, resource development, and reserves are collected separately for oil and gas and are discussed in subsequent chapters.

[6] The data for total U.S. production of crude oil and natural gas liquids and of natural gas (dry) in this report are taken from the Energy Information Administration (EIA), *U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves, 1988 Annual Report*, DOE/EIA-0216(88). This source is utilized in order to preserve consistency between production reported in the context of oil and gas reserves and reserve additions and of production reported elsewhere in this report. However, the official EIA U.S. totals for crude oil and natural gas plant production are 3,593.4 million barrels in 1988 and 3,652.9 million barrels in 1987 (EIA, *Petroleum Supply Annual 1988*, Vol. 1, DOE/EIA-0340(88)/1). For dry natural gas production, the official EIA U.S. totals are 16,642 billion cubic feet in 1988 and 16,536 billion cubic feet in 1987. (EIA, *Natural Gas Monthly*, April 1989 DOE/EIA-0130(89/04.) (The EIA official totals were developed from data provided by Federal and State oil and gas regulatory agencies, whereas the EIA reserves report totals were developed from data collected in EIA survey Form EIA-23, "Annual Survey of Domestic Oil and Gas Reserves," and Form EIA-64A, "Annual Report of the Origin of Natural Gas Liquids Production." Differences between these totals are briefly noted and discussed on pages 43-44 and 47 of the 1988 EIA reserves report.

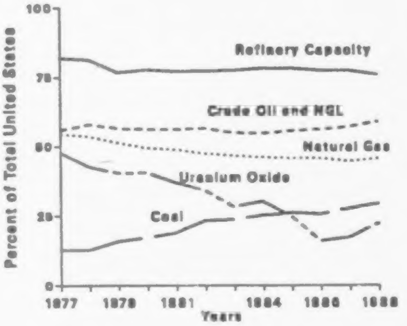
Overall, 1988 was a year of continued financial recovery for the FRS companies despite a renewed fall in crude oil prices. Net income doubled, to $22.3 billion. About one-fourth of the increase in net income resulted from ongoing operations (Table 5). From a line of business standpoint, significant profit gains were achieved in the nonenergy sector, particularly in petrochemicals where crude oil feedstock costs fell and product prices increased as a result of strong demand. Substantial gains were also achieved in the petroleum sector. An improvement in refining operations more than offset the adverse effects of a sharp decrease in crude oil prices in the petroleum production segment. The bulk of the improvement resulted from reduced tax rates, a low level of restructuring charges, and the beneficial effects of other unusual items.

Figure 1. Operating Revenues by Line of Business for FRS Companies, 1981-1988



Source: Energy Information Administration, Form EIA-28.

Figure 2. FRS Companies' Share of U.S. Energy Production and Refinery Capacity, 1977-1988



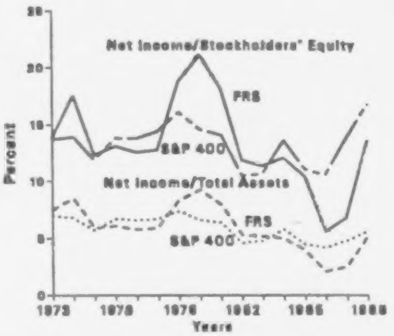
Note: A new series for Uranium Oxide begins in 1986.
Source: See Table B1, Appendix B.

2. Key Financial Trends

From 1974 through 1987, the course of the FRS companies' income and investment was strongly tied to the path of crude oil prices. Crude oil prices in 1988 continued on a generally downward path which began in mid-1987. By late fall 1988, oil prices were near the lows of 1986. Nevertheless, net income of the FRS companies in 1988 nearly doubled from the prior year to $22 billion, the highest level since 1981. Substantial increases in income from downstream petroleum operations and chemical businesses more than offset the decline in net income from oil and gas production. Reduced tax rates and a relative absence of significant restructuring charges in 1988 also contributed to the increase in net income. The FRS companies' net income improved at a considerably greater pace than the net income of other U.S. industrial companies, which contributed to narrowing the gap in profitability between the two groups (Figure 3).

Capital expenditures rose by over 40 percent, to $50 billion. Capital expenditures of $16 billion related to the FRS companies' mergers and acquisitions in 1988 were exceeded only in the mega-merger years of 1982 and 1984.[7] However, even when the effects of mergers and acquisitions are excluded, strong gains in capital outlays occurred in 1988. Increased capital expenditures for almost all phases of petroleum production, processing, and distribution led the upturn.

Figure 3. Selected Performance Measures for FRS Companies and the S&P 400, 1973-1988



Sources: o FRS Companies – Energy Information Administration, Form EIA-28
o S&P 400 – Standard & Poor's Compustat Services, Inc.

Revenue and Income

Overall Results

The FRS companies' total revenues rose by 1 percent between 1987 and 1988, to $420 billion (Table 1). Petroleum revenues were flat and nonenergy revenues rose somewhat (Figure 1). Lower oil and refined product prices in 1988 were offset by increased worldwide oil and gas production volumes and increased volumes of refined product sales. The gain in nonenergy revenues reflected a substantial jump in sales of chemicals.

At $22 billion, the net income of the FRS companies was at the highest level since 1981, the year of peak oil prices. Net income before unusual items improved by $6 billion, reaching levels achieved before the oil price crash of 1986 (Table 2). At the same time, losses attributed to restructuring and asset writedowns declined by $5 billion. These charges adversely affected the FRS companies' financial results prior to 1988. In 1988, on balance, unusual items added $0.2 billion to the FRS companies' bottom-line results. Cash flow, as measured by funds from operations, rose by 12 percent to $58 billion in 1988 (Table 1). The improvement was largely due to the improvement in net income. However, since unusual charges against income generally do not involve cash, cash flow showed a lesser improvement than did net income.

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[7] In 1982, mergers involving FRS companies were Du Pont's acquisition of Conoco, Occidental Petroleum's acquisition of Cities Service, and U.S. Steel's acquisition of Marathon. In 1984, mergers involving FRS companies were Chevron's acquisition of Gulf Oil, Mobil's acquisition of Superior Oil, and Texaco's acquisition of Getty Oil.

Table 1. Comparison of Selected Financial Items for FRS Companies and the S&P 400, 1988

Selected Financial Items	All FRS Companies		S&P 400		Non-FRS S&P 400[a]	
	1988 (billion dollars)	Percent Change From 1987	1988 (billion dollars)	Percent Change From 1987	1988 (billion dollars)	Percent Change From 1987
Income Statement						
Operating Revenues	419.8	0.6	2,206.9	8.1	1,876.0	8.9
Operating Expenses	-381.6	-0.5	-1,979.1	6.2	-1,679.8	6.8
Operating Income	38.2	13.2	227.9	28.8	196.3	30.4
Other Income[b]	-2.4	NM	-33.8	NM	-32.6	NM
Income Taxes	-13.5	-2.0	-67.1	2.3	-55.3	2.4
Net Income	22.3	98.4	127.0	26.5	108.3	18.5
Funds from Operations	57.8	12.0	235.4	7.7	195.2	8.9

[a] S&P 400 excluding FRS companies. Fourteen FRS companies are included in the S&P 400 group.

[b] "Other Income" includes other revenue and expense, extraordinary items, and accounting changes.

NM = Not meaningful.

Sources: FRS companies: Energy Information Administration, Form EIA-28. S&P 400: Standard & Poor's Compustat Services, Inc.

Table 2. Effect of Unusual Items on the Consolidated Net Income of FRS Companies, 1984-1988
(Million Dollars)

Net Income and Unusual Items[a]	1984	1985	1986	1987	1988
Net Income Before Unusual Items	23,600.6	22,479.5	13,885.9	16,213.0	22,155.0
Unusual Items, After Tax[a]	-2,291.7	-5,099.9	-4,719.3	-4,956.0	184.0
Net Income	21,308.9	17,379.6	9,166.6	11,257.0	22,339.0

[a] Unusual items include discontinued operations, writedowns of asset values, provisions for regulatory and litigation matters, personnel reduction costs, extraordinary items, and effects of accounting changes.

Sources: Energy Information Administration, Form EIA-28 and company annual reports to shareholders.

Other industrial companies, as reflected in the Standard & Poor's (S&P) 400 (excluding FRS companies) registered a 19-percent increase in net income.[8] As a result of the greater relative improvement shown by the FRS companies, the gap in profitability between them and the S&P 400 narrowed considerably in 1988: the return on equity for the S&P 400 was 16.9 percent compared to 13.6 percent for the FRS companies (Figure 3).

Results by Lines of Business

Until the oil price plunge of 1986, the FRS companies' oil and gas production operations yielded the highest rates of return of all of their lines of business (Figure 4). Other businesses generally produced rates of return of less than 10 percent. Since 1985, this pattern has changed sharply. Rates of return for downstream petroleum operations recovered from the lows of the 1980's and hit a new peak in 1988 for this decade. Nonenergy rates of return surged in 1987 and 1988 and clearly outperformed the other lines of business in those years. The following section examines the factors affecting the financial performance of the FRS companies' lines of business in 1988. However, since the presence of unusual items noticeably affected the net income[9] of some lines of business, the review in this section will focus on net income excluding unusual items.

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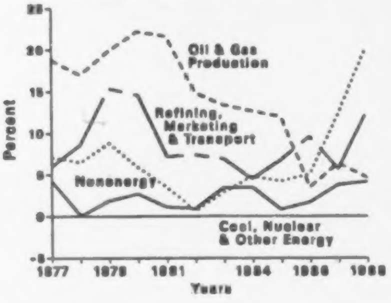
[8] The S&P 400 is a well recognized data base that includes 400 of the largest U.S. industrial companies. In 1988, 16 of the FRS companies were included in the S&P 400. Financial statistics for the S&P 400 were obtained by accessing Compustat, a service of Standard & Poor's Inc.

Oil and Gas Production. The decline in oil prices in 1988 wholly accounted for the 61-percent drop in the FRS companies' net income from U.S. oil and gas operations (Table 3). U.S. wellhead crude oil prices, on an annual basis, declined 18 percent between 1987 and 1988. The oil price decline outweighed the 2-percent increase in the FRS companies' U.S. oil production. The FRS companies' U.S. oil revenues were down by over $5 billion (see Chapter 4 for further discussion of domestic petroleum developments). Partially offsetting the effects of lower oil prices was an increase in the FRS companies' revenues from the production and sale of natural gas. Greater demand for natural gas, stemming from weather conditions and increased industrial and commercial activity, led to increased prices and production. Some FRS companies also increased their purchases and resales of natural gas in 1988. Overall, the FRS companies' natural gas revenues rose by $2.4 billion. Reduced U.S. Federal corporate income tax rates in 1988, from 40 percent to 34 percent, resulted in a $196 million offset to the adverse effects of lower oil prices.

Taxes played a greater role in the FRS companies' foreign oil and gas operations in 1988. Although lower oil prices reduced income from these operations, the 19-percent decline in foreign net income from oil and gas production abroad was less steep than the decline in U.S. oil and gas net income. Foreign host governments apparently reduced taxes on oil and gas operations of multinational companies in 1988. The average income tax rate (income tax expense divided by pretax income) for the FRS companies' foreign oil and gas operations fell from 58 percent to 54 percent between 1987 and 1988 (see Chapter 6 for further discussion of foreign petroleum developments). Abroad, production taxes and royalties fell from $1.47 per barrel (oil and natural gas production on a crude oil equivalent basis) to $0.93 per barrel, a 37-percent decline, between 1987 and 1988. In the United States, State severance and production taxes fell by $0.08 per barrel. In the absence of these reductions, the FRS companies' foreign oil and gas net income would have been $0.8 billion lower in 1988.

Refining and Marketing. The FRS companies' worldwide refining and marketing operations yielded a net income of $7.7 billion in 1988, the highest level since at least 1977, the first year that these data were collected. Although refined product prices generally declined in 1988, compared with 1987, they did not decline nearly as much as crude oil input prices. As a consequence, refiners' margins in 1988 attained their highest level during the 1980's. Margins were high, in part, because refined product price changes tended to lag crude oil price changes. Throughout most of 1988, crude oil prices declined. Given some lag in the response in refined product prices, margins tended to drift upward, particularly in the second and third quarters of 1988. Tightness in refined product markets, particularly gasoline, moderated the decline in product prices. Capacity utilization rates in 1988 were at their highest levels since the late 1970's.

Figure 4. Rates of Return by Line of Business for FRS Companies, 1977-1988



Note: Net income contribution divided by net investment in place.
Source: Energy Information Administration, Form EIA-28.

For the FRS companies, net income from U.S. refining/marketing operations in 1988 rose more than fivefold over 1987, to $5.3 billion. In addition to increased margins, the FRS companies' U.S. refined product sales volumes were up 2 percent which benefited bottom-line results. Abroad, higher margins together with an 8-percent increase in the FRS companies' foreign refining output served to increase their

[9] Line-of-business profit measures should be distinguished from measures which reflect companywide results because the former reflect only allocated income, expense, and asset items. Two measures of income are presented: *operating income and contribution to net income*. *Operating income* by line of business is similar in concept to the operating income measure for total company operations. It is the net of operating revenues and operating expenses (including depreciation, depletion, and amortization) for a line of business. *Contribution to net income* equals operating income plus income from unconsolidated affiliates and gains on disposal of property, plant, and equipment (PP&E) less income taxes imputed to the line of business and excludes certain non-allocable items, primarily interest expense. Interest expense is the principal source of difference between a companywide net income figure and line-of-business contributions to net income (see Appendix A for further discussion). Line-of-business rates of return are calculated as the line-of-business contribution to net income divided by net investment in place for the line of business. This latter value is equal to the value of net PP&E plus the value of investments and advances to unconsolidated affiliates for the line of business.

Table 3. Contributions to Net Income by Line of Business for FRS Companies, 1987-1988
(Million Dollars)

Line of Business	Net Income 1987	Net Income 1988	Net Income Percent Change 1987-1988	Net Income Excluding Unusual Items 1987	Net Income Excluding Unusual Items 1988	Net Income Excluding Unusual Items Percent Change 1987-1988
Petroleum						
U.S. Petroleum						
Production	4,749.0	3,166.0	-33.3	4,801.0	1,888.0	-60.7
Refining/Marketing	1,073.0	5,443.0	407.3	1,054.0	5,314.0	404.2
Pipelines	2,596.0	1,981.0	-23.7	2,830.0	2,463.0	-13.0
Total U.S. Petroleum	8,425.0	10,581.0	25.6	8,692.0	9,836.0	13.2
Foreign Petroleum						
Production	5,449.0	4,337.0	-20.4	5,445.0	4,390.0	-19.4
Refining/Marketing	987.0	2,427.0	145.9	968.0	2,428.0	150.8
International Marine	-67.0	118.0	NM	-67.0	108.0	NM
Total Foreign Petroleum	6,368.0	6,889.0	8.2	6,345.0	6,933.0	9.3
Total Petroleum	14,794.0	17,470.0	18.1	15,038.0	16,769.0	11.5
Coal	440.0	586.0	33.2	474.0	605.0	27.6
Nuclear and Other Energy	18.0	-84.0	NM	47.0	-78.0	NM
Nonenergy	7,115.0	10,767.0	51.3	7,256.0	10,662.0	46.9
Total Allocated	22,367.0	28,739.0	28.5	22,815.0	27,958.0	22.5
Allocated Unusual Items, After Tax	–	–	NM	-448.0	781.0	NM
Nontraceables and Eliminations	-11,110.0	-6,400.0	NM	-11,110.0	-6,400.0	NM
Consolidated	11,257.0	22,339.0	98.4	11,257.0	22,339.0	98.4

– = Not applicable.
NM = Not meaningful.
Note: Sum of components may not equal total due to independent rounding and/or nontraceables and eliminations.
Source: Energy Information Administration, Form EIA-28.

foreign refining/marketing net income by 151 percent, to $2.4 billion.

The refining/marketing results for 1988 may indicate that the profitability of these operations is approaching normal rates of return. With the exception of 1986, the rate of return to FRS companies' refining/marketing assets was very low during the 1980's (Figure 4). From 1980 through 1985, the FRS companies made substantial reductions in their crude oil distillation capacity both in the United States and abroad. Over the same period, substantial investments for refinery upgrading were undertaken. Since 1986, FRS refining capacity has been fairly stable, indicating that the adjustment to market conditions is largely completed.

Transportation. Net income from the FRS companies' pipelines segment declined by 13 percent between 1987 and 1988, to $2.5 billion. The decline was almost entirely concentrated in natural gas transmission operations, with net income from liquids pipelines operations falling by only 5 percent. The natural gas transmission sector has been adjusting to sharp alterations in the regulatory environment in recent years. In moving to a more competitive environment, the bottom-line results of natural gas transmission companies have been adversely affected. In 1988, revenues fell but operating expenses (excluding charges for settlement of natural gas contracts) were unchanged. As a result, for FRS companies involved in natural gas transmission, net income from pipelines, excluding unusual items, declined by 29 percent between 1987 and 1988.

The FRS companies' international marine operations registered positive net income in 1988 for only the second time in the 1980's. Net income was $108 million in 1988, a turnaround from losses of $67 million in 1987. Increased transport revenues, up 17 percent from 1987, due to greater tanker trade and a 7-percent drop in general operating expenses, largely due to lower fuel prices, were responsible for the improvement.

Coal, Nuclear, and Other Energy. The FRS companies' coal operations registered a 28-percent increase in net income in 1988, to $605 million, the second highest level since at least 1977. Although coal prices fell slightly between 1987 and 1988, the FRS companies' coal production was up 12 percent, yielding a 7-percent increase in coal revenues (see Chapter 7 for further discussion of coal and other energy operations). Unit production costs declined slightly, largely due to a shift towards Western coal production. The rate of return on coal investment in 1988 attained the highest value in 11 years.

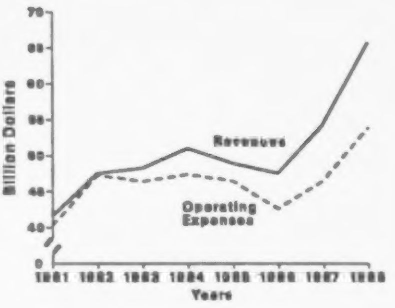
The bulk of the FRS companies' assets and sales in other energy reflect production from Canadian tar sands and production of electricity from geothermal energy sources. The remainder of the FRS companies' activity consists of uranium production, oil shale development, and a variety of nonconventional energy projects. This segment has been of declining interest to the FRS companies. In 1988, only 8 FRS companies reported other energy sales revenue, down from 11 companies in 1987. The peak year of involvement of FRS companies was 1980, when 18 companies reported revenues of $2.0 billion. In 1988, revenues were $811 million compared with $913 million in 1987. Most of the reduction reflected the exit of companies in 1988. The FRS companies reported net losses of $78 million in 1988 in other energy operations compared with net income of $47 million in 1987. Most of the decline appeared to be related to lower prices for tar sands production and generally higher operating costs.

Nonenergy. The FRS companies' net income from nonenergy operations continued to surge in 1988, rising by $3.4 billion from 1987 to $10.7 billion. The increase in 1988 followed increases of $2.5 billion in 1987 and $2.2 billion in 1986. Especially favorable conditions in the chemicals industry in recent years and massive restructuring of diversified businesses underlie the considerable improvement in the financial performance of the FRS companies' nonenergy operations.

In 1988, the FRS companies' chemical revenues rose 21 percent, to $66 billion, following a 14-percent increase in 1987 (Figure 5).[10] Operating expenses also increased, but at a considerably lesser rate. Lower oil prices in 1988 served to restrain chemical feedstock prices. As a result, operating income rose by 51 percent between 1987 and 1988 (Table 4). The rate of return on assets in chemical operations has nearly quadrupled in 3 years.

The FRS companies' income from diversified businesses also showed a considerable increase in recent years. In part, the improvement reflected the shedding of unprofitable businesses. Beginning in 1982, the value of disposals of other nonenergy assets increased noticeably, reaching a peak of $3 billion in 1986. Since 1986, the value of other nonenergy assets sold, or otherwise disposed of, declined and, in 1988, reached the lowest value since 1981. The retained businesses have contributed to the improvement in the FRS companies' financial performance. The rate of return for those businesses nearly doubled between 1987 and 1988.

Figure 5. Revenues and Operating Expenses for the Chemical Segment for FRS Companies, 1981-1988



Source: 1981–1986: Energy Information Administration, Form EIA-28. 1987 and 1988: company annual reports to shareholders.

Non-operating Factors and Earnings Improvement

Much of the increase in net income between 1987 and 1988 stemmed from factors additional to improved operating results. These factors include lower tax rates, discontinued operations, and reduced charges against income for restructuring and writedowns of asset values. Table 5 presents an analysis of these factors.

The improvement in earnings due to lower effective tax rates was computed by applying the FRS companies' 1987 effective tax rate to 1988 pretax income (excluding unusual items) and subtracting the actual 1988 income tax expense (excluding unusual items) from this amount. Lower tax rates, so computed, contributed $3 billion to the FRS companies' net income between 1987 and 1988. Corporate income tax rates were reduced both in United States and abroad. In the United States, the Federal corporate income tax rate was reduced from 40 percent in 1987 to 34 percent in 1988, thus benefiting profitable domestic operations. The overall effective tax rate on the FRS companies' foreign

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[10] For FRS purposes, separate reporting of income for chemical and other nonenergy segments was discontinued beginning with the 1987 reporting year. However, the disclosures of chemical segment revenues and operating income made by the FRS companies in their annual reports to shareholders closely track, in the aggregate, the comparable disclosures in the Form EIA-28 from 1981 through 1986. Thus, the public disclosures of chemical segment revenue and operating income were utilized for 1987 and 1988. Revenues and operating income for the other nonenergy segment in 1987 and 1988 were obtained by subtracting the publicly disclosed chemical segment values from the nonenergy line-of-business values reported on Form EIA-28. It should be noted that the results for chemicals are qualitatively unchanged if Du Pont is excluded.

Table 4. Operating Income and Operating Rate of Return in the Chemicals and Other Nonenergy Segments for FRS Companies, 1985-1988

Segment	1985	1986	1987	1988	Percent Change 1987-1988
	(million dollars)				
Operating Income, Excluding Unusual Items					
Chemicals	2,495	5,057	8,060	12,133	50.5
Other Nonenergy	587	2,174	2,404	3,321	38.1
	(percent)				
Operating Rate of Return[a]					
Chemicals	12.5	34.2	36.5	47.2	–
Other Nonenergy	1.8	7.9	7.9	14.1	–

[a] Operating income (excluding unusual items) divided by net property, plant, and equipment.

– = Not applicable.

Source: Energy Information Administration, Form EIA-28, except for chemicals segment operating income for 1987 and 1988 which was compiled from company annual reports to shareholders.

petroleum operations declined because the effective tax rate on income from oil and gas production declined from 58 percent in 1987 to 54 percent in 1988 and because the composition of income shifted to the lower taxed refining/marketing segment. The bulk of the FRS companies' foreign refineries are located in Canada and western European nations where tax rates tend to be lower than in other oil producing nations.

Increased income from discontinued operations contributed $1.4 billion to the increase in the FRS companies' net income. Income from discontinued operations consists of income or losses generated from operations sold by a company in the year of the sale, plus the gain or loss due to the difference between the sales price of the operations and the book value of the assets sold. Over 90 percent of the income from discontinued operations stemmed from Tenneco's sale of their worldwide petroleum operations in 1988. Other significant sales of operations included BP America's sale of their animal feed business, Mobil's sale of Montgomery Ward, and Union Pacific's sale of its refining and marketing operations.

The remaining source of improvement in net income is attributable to a reduction in other unusual items. These unusual items consist of a variety of asset writedowns, restructuring charges, the financial effects of litigation settlements, and the effect of changes in accounting standards. In 1987, the value of unusual items, apart from discontinued operations, was a negative $4.9 billion, largely attributable to Texaco's charges for restructuring and an adverse litigation settlement. In 1988, the comparable value was a negative $1.2 billion. No company reported a value of writedowns in excess of $400 million in 1988 and charges against income were partially offset by favorable litigation settlements.

These other sources of earnings improvement, in total, accounted for nearly 75 percent of the $11 billion increase in the FRS companies' net income between 1987 and 1988. However, these sources were either in part or in whole, nonrecurrent, dependent upon changes in fiscal regimes, or unrelated to operating performance. Thus, the interpretation of the FRS companies' improved financial performance in 1988 should be tempered by recognizing the large role played by these sources. However, since charges against income for restructuring and writedowns were greatly reduced, net income for 1988 more clearly reflected the results of operations than in earlier years.

Table 5. Sources of Increase in Net Income for FRS Companies, 1988

Source	Change 1987-1988	Share of Net Income Change
	(million dollars)	(percent)
After-Tax Operating Results[a]	2,933	26.5
Reduction in Effective Tax Rates[b]	3,009	27.2
Discontinued Operations	1,367	12.3
Other Unusual Items	3,773	34.0
Total Change in Net Income	11,082	100.0

[a] Assumes 1987 effective tax rate for 1988. Excludes unusual items.

[b] Difference between income tax expense computed at 1987 effective tax rate for 1988 and reported 1988 income tax expense. Excludes unusual items.

Source: Energy Information Administration, Form EIA-28 and company annual reports to shareholders.

StarEnterprise

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February 16, 1990

The Honorable Warren B. Rudman
United States Senate
Washington, DC 20510

Dear Senator Rudman:

Mr. Glenn F. Tilton, President, Texaco Refining and Marketing Inc., appeared before the United States Senate Government Affairs Committee on January 16, 1990 and gave testimony on the home heating oil supply, demand and price movements which occurred during the bitterly cold month of December 1989. This letter is in response to your request to provide further clarification of Mr. Tilton's remarks concerning refinery and distribution system operation during that period and to provide insight into how we determine when to run our refining/marketing system in the distillate (heating oil) or gasoline mode of operation. Please treat the information contained in this letter as proprietary and protect its strict confidentiality.

Star Enterprise is the marketer of Texaco-branded products in the area addressed by the Committee. Star Enterprise is a joint venture between Texaco Refining and Marketing (East) Inc. and Saudi Refining, Inc. Star Enterprise owns and operates three refineries located at Delaware City, Delaware; Convent, Louisiana; and Port Arthur, Texas. Products from these refineries are distributed and sold in 26 states from Texas to Maine and the District of Columbia. A map of the Star Enterprise marketing area is attached for your reference.

Mr. Charles J. DiBona, President, American Petroleum Institute, appeared with Mr. Tilton at the same committee session. In the question and answer session following his testimony, Mr. DiBona, speaking for the petroleum industry in general, stated that it would be costly for a refiner to switch abruptly from a planned gasoline mode of operation to a distillate mode of operation. While we cannot address this issue from an industry perspective, we can provide some insight as to when and how Star Enterprise goes about making this switch.

We agree with Mr. DiBona that switching abruptly from a planned gasoline mode of operation to a distillate mode can be costly. Because of the lead times required to produce, distribute and market a desired refinery product slate, it could prove costly and difficult for Star Enterprise to abruptly switch from almost any planned major course of action to increase the production of one product to meet a temporary, unexpected demand. For example, if the demand for gasoline were to escalate in December due to a temporary shortage, we could not immediately meet that demand by altering our refinery crude slates and/or product slates from a normal distillate operation. The demand increase of one product relative to another must take place and be maintained for a relatively long duration (e.g., more than one month) before we could economically justify making such refinery operating mode changes. And even then, prudent operating practice would require that we proceed with such a switch in a deliberate, orderly fashion.

During the summer months, when our nation is in the peak driving season, our refineries are normally in maximum gasoline operation. Toward the end of the peak driving season, demand for gasoline begins to decrease, and inventories of No. 2 fuel oil are built up in anticipation of the coming winter. As the demand for No. 2 fuel oil reaches a certain level relative to gasoline, our refineries begin the switchover from maximum gasoline to maximum distillate operation. This switchover could involve changes in crude oil mix, changes in distillation boiling ranges of certain intermediate product streams and/or changes in the operating conditions of key refinery processing units. Depending upon the relative demand of No. 2 fuel oil and gasoline, owing to changes in weather patterns, this switchover has occurred in some years as early as September and in other years as late as early December. During the latter part of December 1989, when the unanticipated upswing in demand for distillates occurred, our refineries were already producing maximum distillates. Throughout the fourth quarter of 1989, we were attempting to maximize distillate production and shipments.

We further submit the following highlights of our refinery operations during the fourth quarter of 1989:

- Our Delaware City refinery shipped over 500,000 barrels or 21 million gallons more distillate products in the fourth quarter of 1989 than it did during the comparable period for 1988.

- The Delaware City refinery set a distillate shipping record throughout the month of December of 73 million gallons.

- In an unprecedented move, the Delaware City refinery switched a hydrotreater dedicated to gasoline manufacture to distillate service to further increase distillate shipments in December in an attempt to meet these extraordinary customer needs.

- Our Convent, Louisiana refinery shipped over 970,000 barrels or 41 million gallons more distillate products in the fourth quarter of 1989 than during the comparable period for 1988.

- Our Port Arthur, Texas refinery shipped 2.2 million barrels or 92 million gallons more distillate products in the fourth quarter of 1989 than during the comparable period for 1988.

- All of our refineries were at maximum distillate production by mid-October.

- In the fourth quarter of 1989 Star Enterprise's refineries produced a total of 18.8 million barrels of distillate and shipped 18.6 million barrels. In December 1989 Star Enterprise's refineries produced a total of 6.8 million barrels of distillate and shipped 7.0 million barrels. Further shipments were limited by lack of availability of ships and

norable Warren B. Rudman
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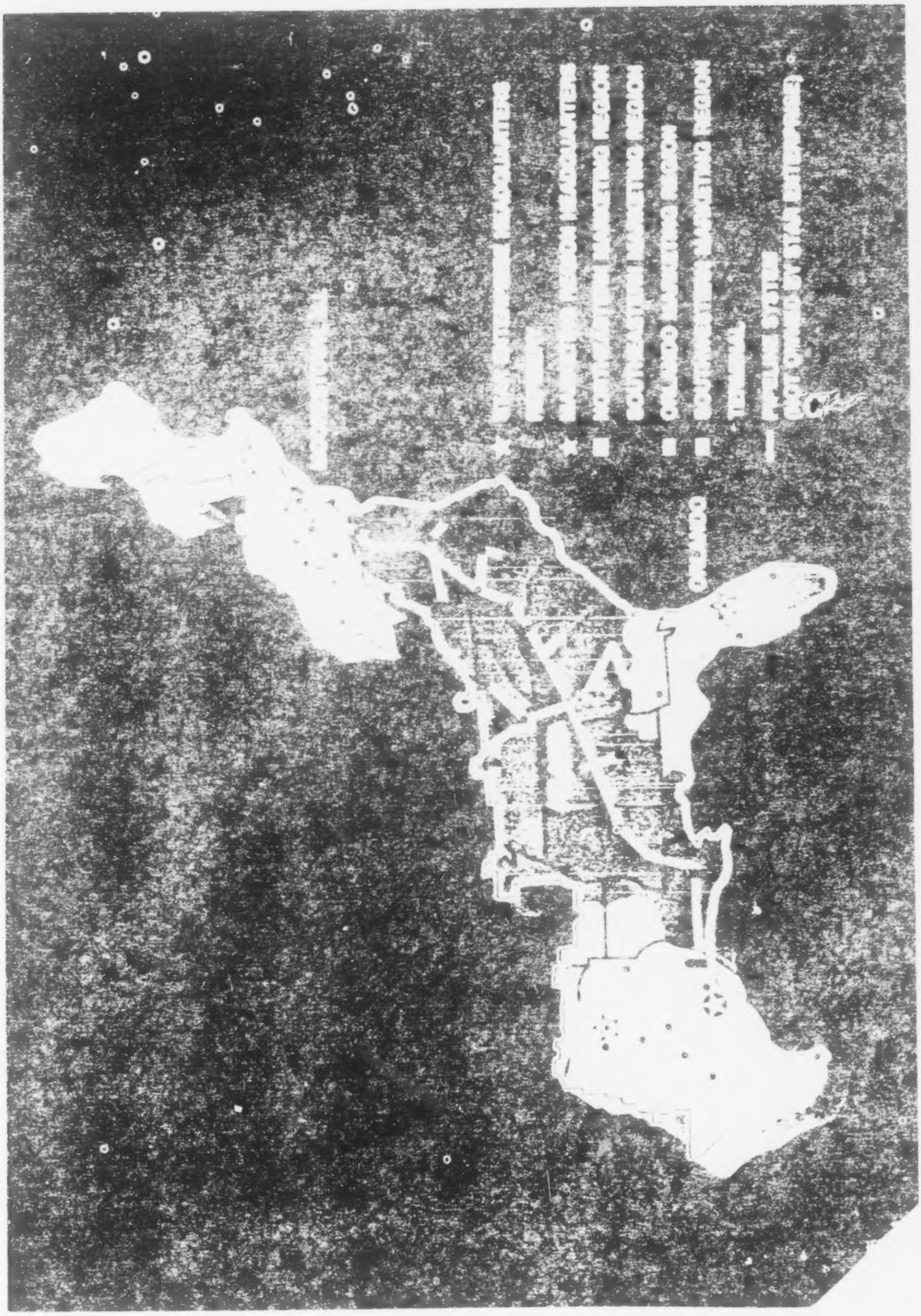
barges in December for deliveries from our Delaware City refinery.

Despite all of these efforts and shipping records, Star Enterprise was forced to purchase 41 million gallons of home heating oil on the open market in December to ensure that we met our customers' needs.

We trust that this information is helpful in your understanding of the December 1989 price and supply situation for No. 2 fuel oil in the Northeastern region of the United States. We are extremely proud of the untiring and unselfish extra-effort put forth by Star Enterprise people in meeting this challenge. We hope you share our pride in these accomplishments.

Very truly yours,

RAP:lb
04/5

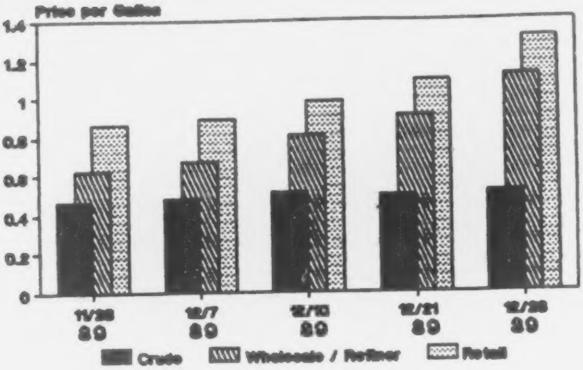

STAR ENTERPRISE HEADQUARTERS
MARKETING REGION HEADQUARTERS
NORTHEASTERN MARKETING REGION
SOUTHEASTERN MARKETING REGION
ORLANDO MARKETING REGION
SOUTHWESTERN MARKETING REGION
TERMINAL
PIPELINE SYSTEM
(NOT OWNED BY STAR ENTERPRISE)
ORLANDO

Estimated Refiner Margin

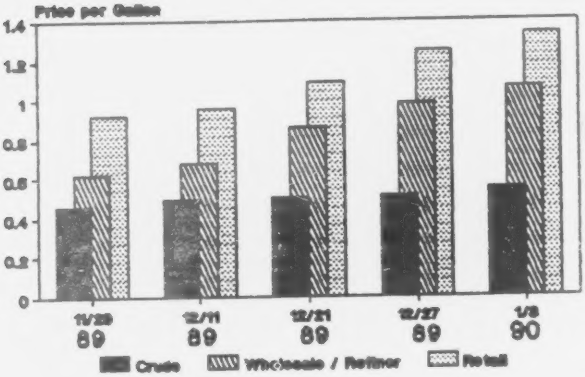
State	9/89	10/89	11/89	12/89	% change
Connecticut	18.4	19.7	19.3	67.9	270.0%
Rhode Island	18.4	19.9	19.3	68.7	274.3%
New Jersey	16.7	18.4	17.8	68.9	313.8%
New York	18.4	20.1	18.0	56.6	208.4%
Pennsylvania	15.5	17.1	17.2	59.2	283.1%
Michigan	17.8	20.4	18.0	45.3	155.2%
Ohio	18.2	19.5	19.0	45.9	152.9%
Wisconsin	16.9	18.5	17.2	44.6	164.7%

Source: Energy Information Administration and Citizen Action.

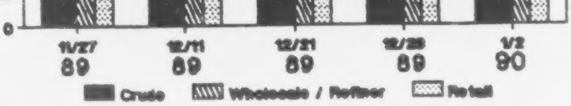
#2 Heating Oil, Philadelphia, PA

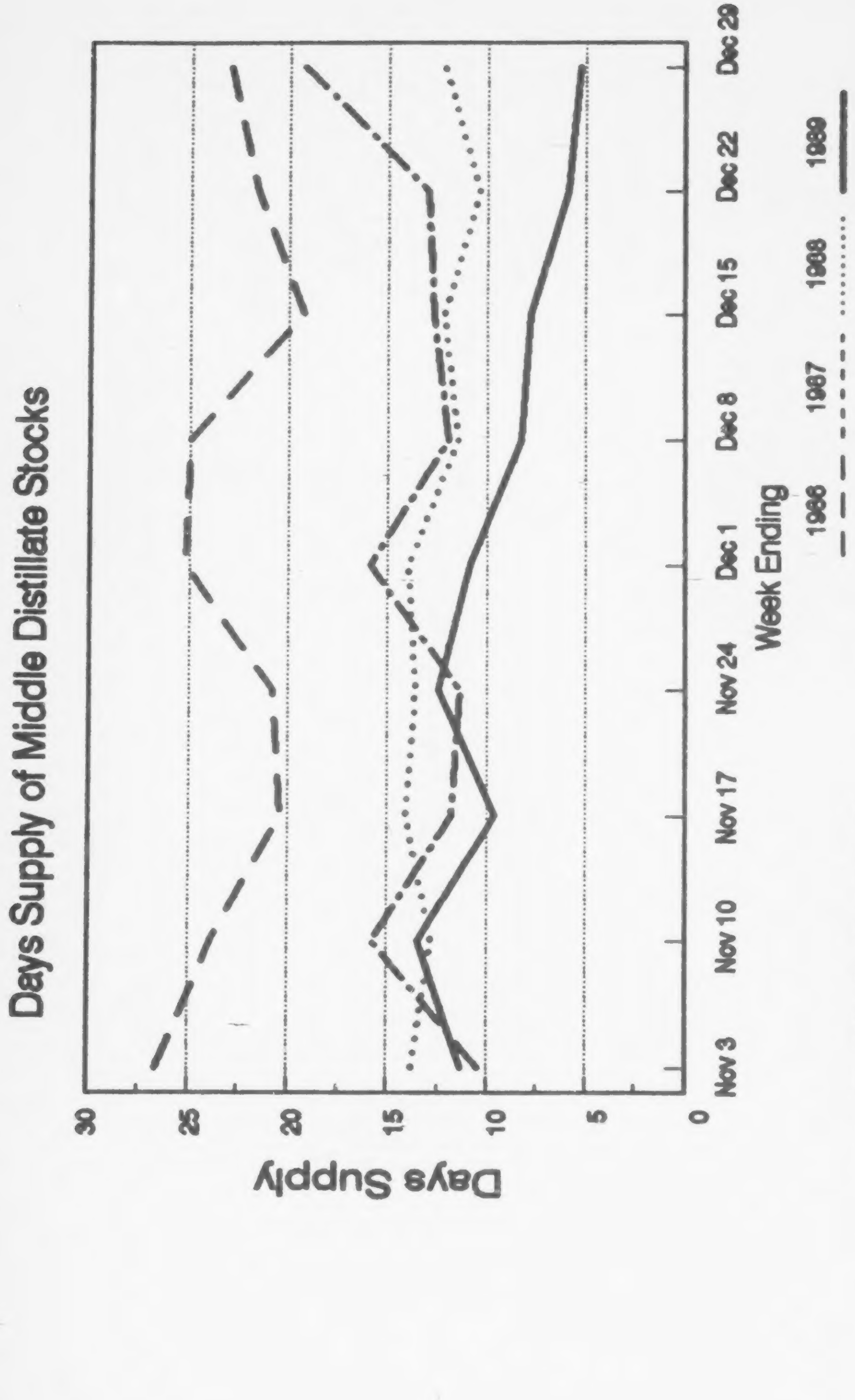


#2 Heating Oil, Baltimore, MD



#2 Heating Oil, Washington, D.C.

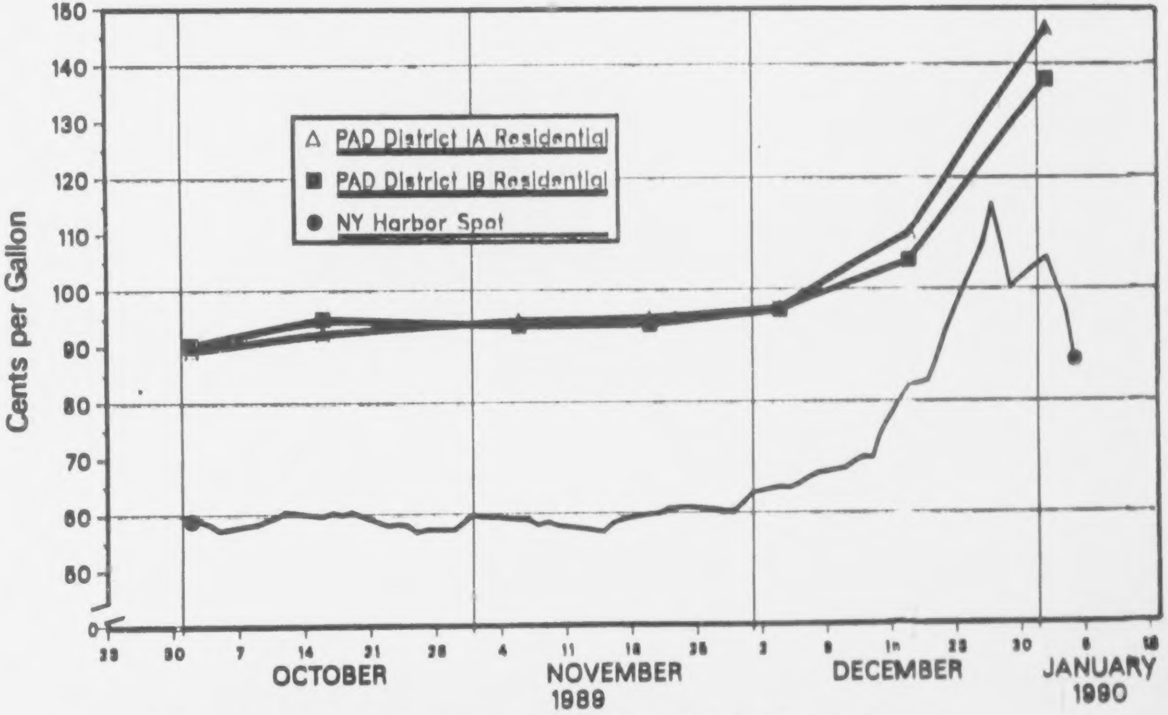




Days Supply of Middle Distillate Stocks

Source: Weekly Petroleum Status Report, EIA.

RESIDENTIAL AND SPOT NO. 2 FUEL OIL PRICES, Fourth Quarter, 1989

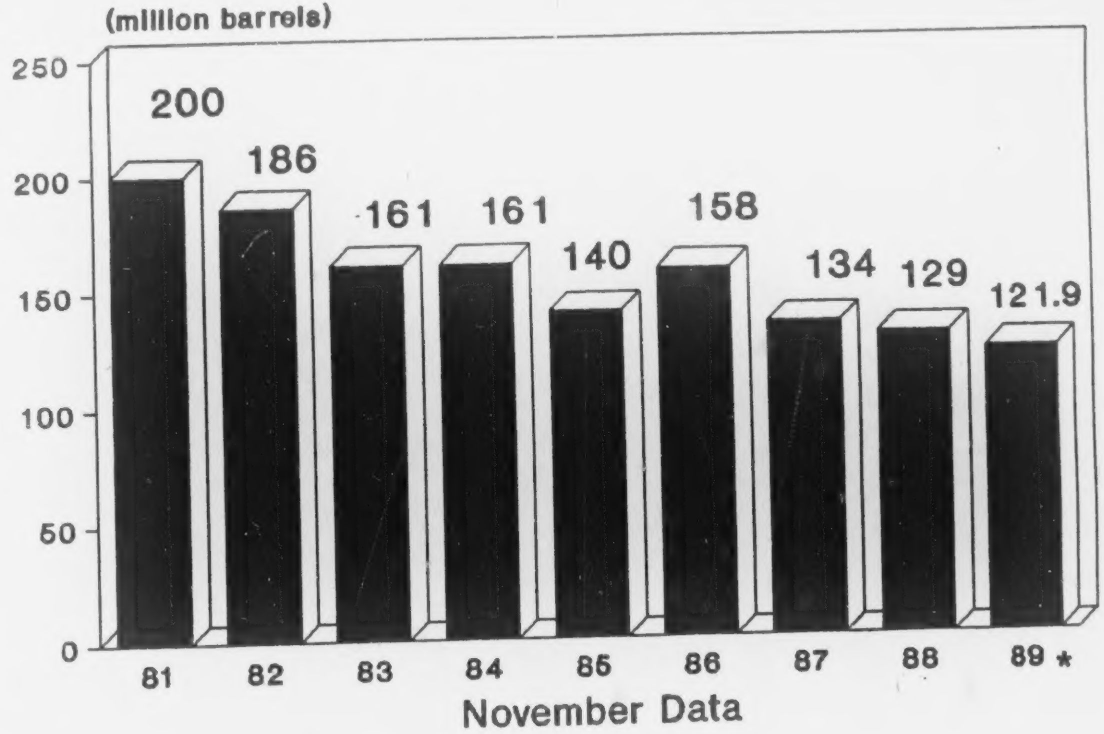


Note: PAD District IA includes Connecticut, Maine, Rhode Island, and Vermont.
PAD District IB includes Delaware, New Jersey, New York, and Pennsylvania.

Source: EIA/State Heating Oil Program and Reuters.

GRAPH 4

Distillate Fuel Oil Ending Stocks



Source:Energy Information Administration